

**Denmark: 2004 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Denmark**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with Denmark, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 30, 2004, with the officials of Denmark on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 2, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of July 28, 2004 updating information on recent developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its August 2, 2004 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Denmark.

The document listed below have been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

DENMARK

**Staff Report for the 2004 Article IV Consultation**

Prepared by Staff Representatives for the 2004 Consultation with Denmark

Approved by Alessandro Leipold and Martin Fetherston

July 2, 2004

- The 2004 Article IV consultation discussions were held in Copenhagen during March 19–30, 2004. The mission, comprising Messrs. MacArthur (Head, PDR), Eskesen, and Hunt, and Ms. Honjo (all EUR), met with Mr. Pedersen, the Minister for Finance, Ms. Andersen, Governor of the Nationalbank, senior government officials, representatives of regulatory and supervisory agencies, municipal governments, the Economic Council, the Welfare Commission, the Association of Mortgage Banks, the two major banks, and trade union and employers' confederations.
- At the conclusion of the last consultation in May 2002, Directors commended the authorities for their sustained strategy of fiscal discipline and structural reform. Directors noted that pressures on the high level of taxation and the desire to maintain a comprehensive welfare system could pose challenges for the medium term. Directors agreed that improving public expenditure discipline should be a priority.
- A coalition of the Liberal and Conservative parties form the current government with the next election to be held at the latest by November 2005.
- Denmark has accepted the obligations of Article VIII, Sections 2, 3, and 4. The exchange system is free of restrictions on payments and transfers for current international transactions (Appendix II).
- Denmark has subscribed to the Special Data Dissemination Standard, and data provision is adequate for surveillance (Appendix III).
- The authorities released the mission's concluding statement and agreed to the publication of the staff report.

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## EXECUTIVE SUMMARY

**Background and Outlook:** Between 1993 and 2000 Denmark enjoyed a period of rapid economic growth supported by sound macroeconomic fundamentals and structural reform. In 2001, a slowdown began. Initially, fiscal measures aimed at cooling an overheating economy led to an easing in private consumption expenditure while net exports and investment supported growth. The downturn in the global economy eventually spilled over into net exports in 2002 with the resulting impact on business confidence leading to a decline in investment in 2003. Currently, conditions appear to be in place for a return to healthy growth. In the medium term, Denmark is relatively well prepared to deal with the fiscal pressures that will arise as the population ages.

### **Policy discussions focused on the following key issues:**

- The macroeconomic fundamentals underlying the expected rebound; and
- the additional efforts that will be required to achieve the medium-term employment and public expenditure targets underlying the authorities' strategy for ensuring fiscal sustainability given the pressure from an aging population and the objective of maintaining the welfare state without increasing taxes.

### **Authorities and staff agreed that:**

- The conditions appear to be in place for a return to growth close to the economy's potential rate. Domestic balance sheets are healthy. Monetary and fiscal policy are supportive. The world recovery is strengthening and leading indicators suggest that the pickup in the domestic economy witnessed late last year continues to gain momentum.
- Inflation pressures will remain subdued. Although the impact of the reduction in indirect taxes and euro appreciation are temporary, capacity constraints are unlikely to be reached until the end of 2005.
- Although Denmark is well placed to deal with the fiscal pressures of an aging population, additional measures will be required to achieve the structural employment targets underlying the medium-term sustainability strategy.

### **The staff recommended that:**

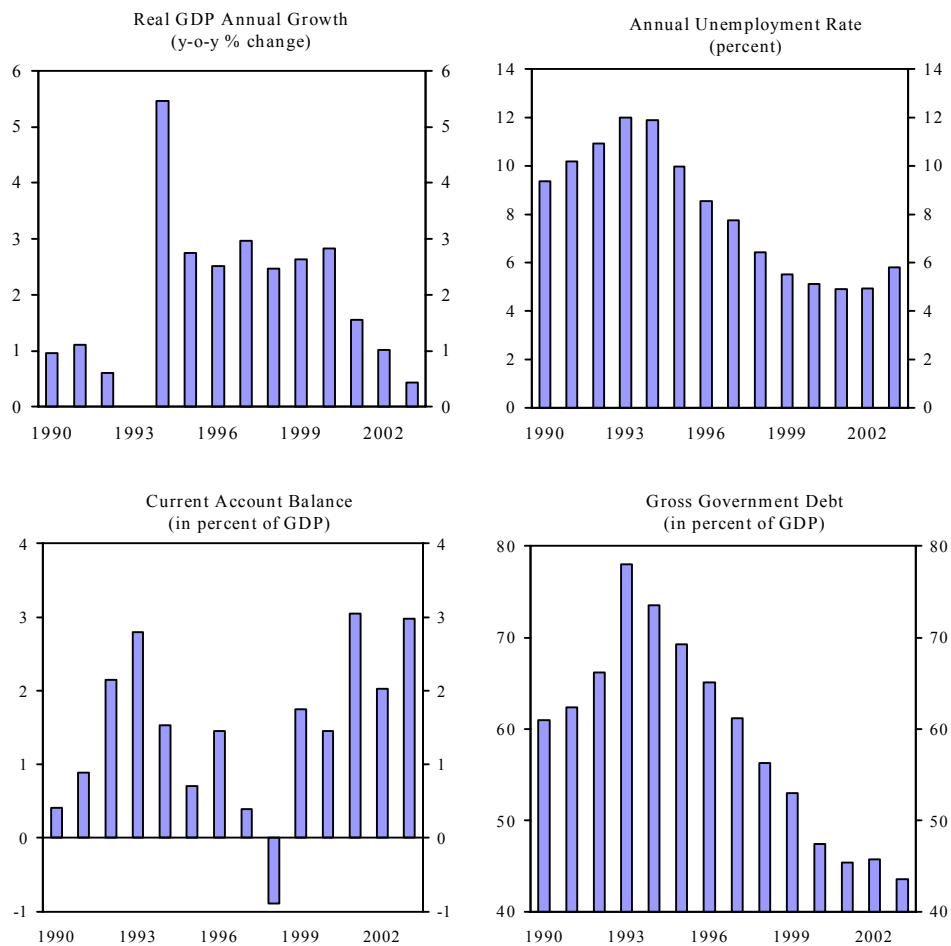
- Constraints on public consumption expenditure be strengthened by expressing the expenditure targets in nominal terms and introducing user fees in healthcare.
- To achieve the structural employment targets priority should be given to reform of early retirement schemes, continued progress in product market reforms and further improvements in the tax system to increase incentives to work.

## I. BACKGROUND

### 1. Denmark's stability-oriented economic reforms took hold in the early 1990s and the country enjoyed a period of rapid economic growth over 1993–2000 (Figure 1).

Initially, accommodative fiscal policy and a consumption boom stimulated by lower interest rates and mortgage market reforms provided the impetus. In the subsequent period of robust economic activity, labor market reforms led to a significant and sustained labor supply response, reinforcing the pickup in growth and ensuring its sustainability. Fiscal reforms, the introduction of a formalized medium-term fiscal framework, and the growing economy transformed fiscal deficits into sizable surpluses. Government debt fell from a peak of almost 80 percent of GDP in 1993 to 45 percent by the end of the decade. Consistent with the improvement in domestic saving, Denmark registered current account surpluses through most of the 1990s and its foreign debt position also improved markedly.

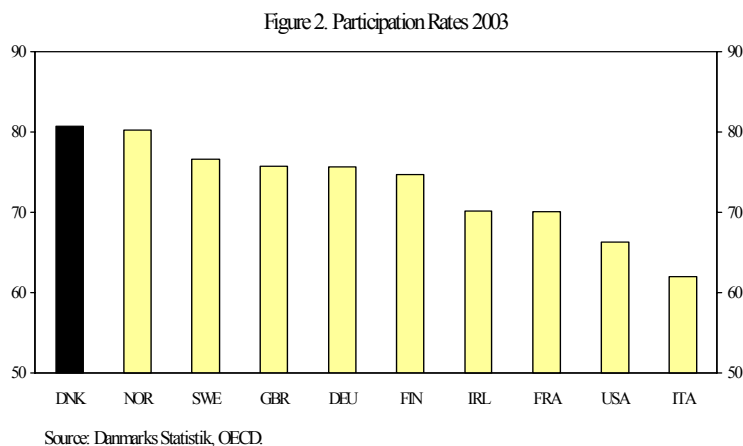
Figure 1. Denmark: Long-Term Indicators



Sources: Danmarks Statistik, OECD.

**2. Denmark has maintained high employment even in the presence of generous social benefits.**

Denmark offers unemployment insurance replacement rates that are among the highest in the OECD and generous welfare benefits, but labor market participation rates are also among the highest in the OECD (Figure 2). At least



part of this may be credited to Denmark’s flexible recruitment and dismissal rules, strict requirements regarding participation in active labor market programs such as education and training, and clear availability-for-work criteria to qualify for benefits.

**3. As in much of Europe, growth slowed starting in 2001 (Table 1, Figures 3–5).**

Consumption spending weakened in response to domestic fiscal initiatives aimed at cooling an overheating economy, while investment and net exports supported growth. More recently, net exports slowed as the appreciating euro and the global economic slowdown reduced external demand. Investment, which had remained strong as storm related construction and major infrastructure investment projects were completed, eventually weakened as well in 2003 as tepid external demand undermined business confidence. Toward the end of 2003 domestic demand picked up resulting in annual growth of 0.4 percent. With output now estimated to be roughly 1 percent below potential, the unemployment rate has risen steadily from its trough of 5 percent in 2002 to 6½ percent.

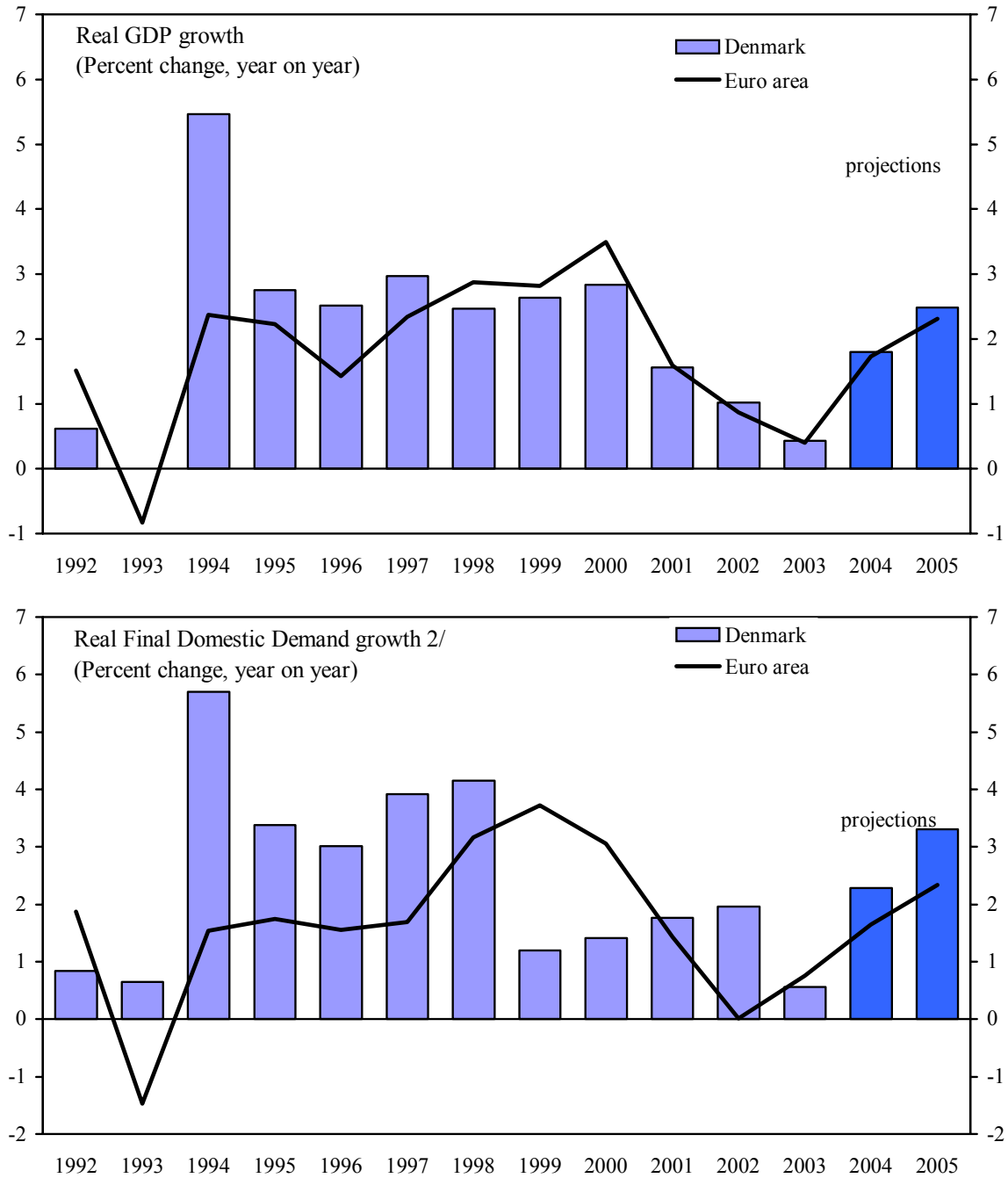
Denmark: Contributions to GDP Growth, 2000–05  
In Percent

	2000	2001	2002	2003	2004	2005
Real GDP growth	2.8	1.6	1.0	0.4	1.8	2.5
Domestic demand	2.4	1.0	1.8	0.1	2.2	2.7
Final domestic demand	1.4	1.7	2.0	0.6	2.3	2.8
Consumption	-0.1	0.6	0.8	0.6	1.6	1.7
Private	-0.4	-0.1	0.3	0.5	1.4	1.5
Public	0.2	0.7	0.5	0.1	0.2	0.2
Fixed investment	1.5	1.1	1.0	-0.1	0.6	1.0
Inventories	0.9	-0.7	-0.1	-0.4	-0.1	-0.1
Net exports	0.5	0.6	-0.8	0.3	-0.4	-0.2
Exports	5.5	2.0	2.2	0.1	1.5	2.2
Imports	5.0	1.4	3.0	-0.2	1.9	2.4

Source: Danmarks Statistics, Staff Forecast 2004 -05



Figure 3. Denmark: Output Developments, 1992–2005 1/

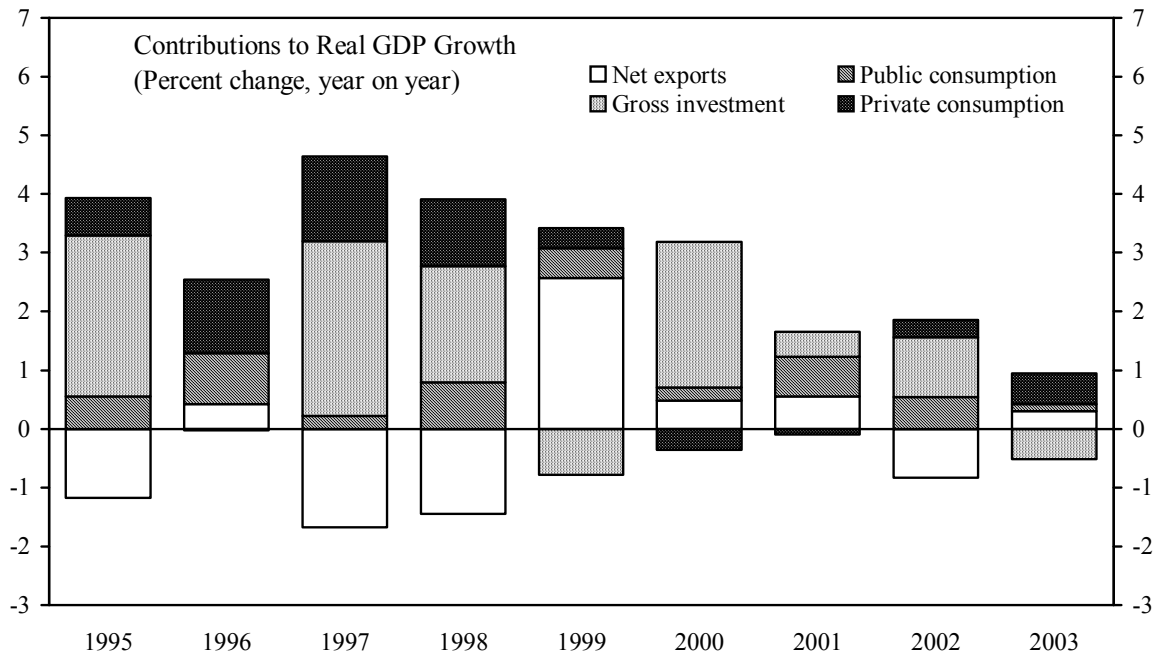
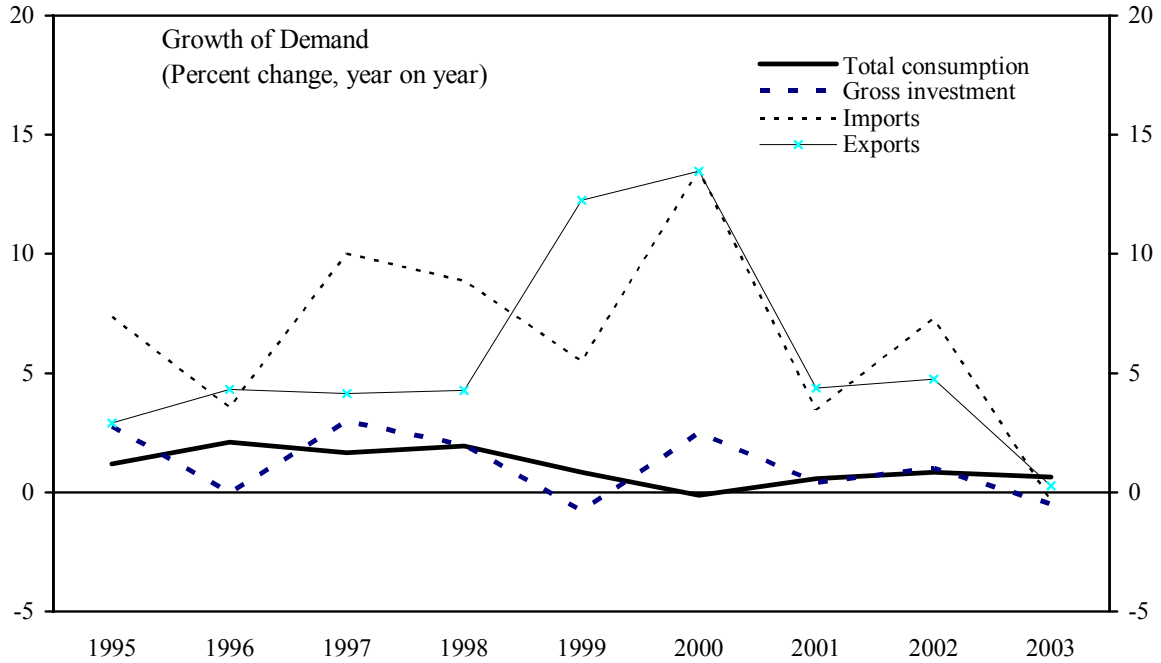


Sources: Danmarks Statistik, staff calculations.

1/ Fund staff projections for 2004-2005.

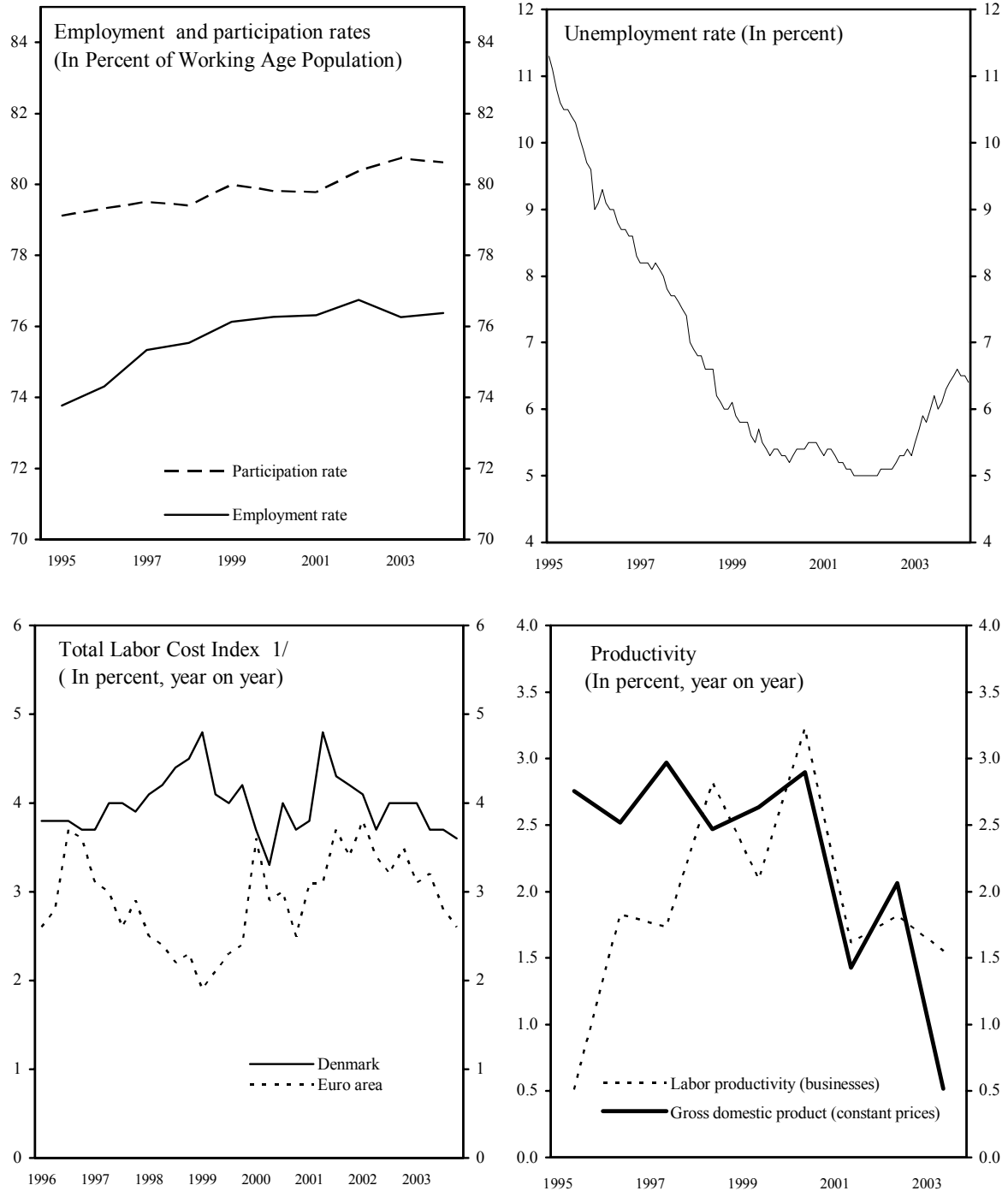
2/ Consumption plus investment.

Figure 4. Denmark: Demand Developments and Components, 1995–2003



Sources: Danmarks Statistik, staff calculations.

Figure 5. Denmark: Employment, Unemployment, and Participation Rate, 1995–2004



Sources: OECD, Analytical database; and Employment Outlook 2000; Eurostat; staff calculations; and data provided by the authorities.

1/ Labour Cost Index (non-seasonally adjusted, in nominal values) in whole economy (except agriculture, education and health). Growth rate Q/Q-4.

4. **Once the slowdown started to affect unemployment, a sound underlying fiscal position provided space to let automatic stabilizers work (Figure 6).** Consistent with medium-term sustainability objectives and reflecting overruns in 2002, constraints on public consumption expenditure in 2003 led to a small tightening of the structural fiscal position. However, this was more than offset by the cyclically-driven increase in social transfers and unemployment benefits together with slower tax collections (also partly due to a tax freeze). The fiscal surplus fell to 1.2 percent of GDP in 2003 from 1.6 percent the preceding year.

Summary of General Government Accounts  
(In percent of GDP)

	2001	2002	2003	2004
	Actual	Actual	Prelim.	Staff
Revenues	57.1	56.1	56.0	55.9
Expenditure	54.2	54.6	54.8	54.7
Balance	2.8	1.6	1.2	1.2
Structural balance	2.4	1.6	2.1	2.0
Primary structural balance	4.0	2.9	3.2	2.8
Fiscal impulse 1/	0.0	1.1	-0.3	0.4
Output gap	0.7	0.1	-1.1	-1.1

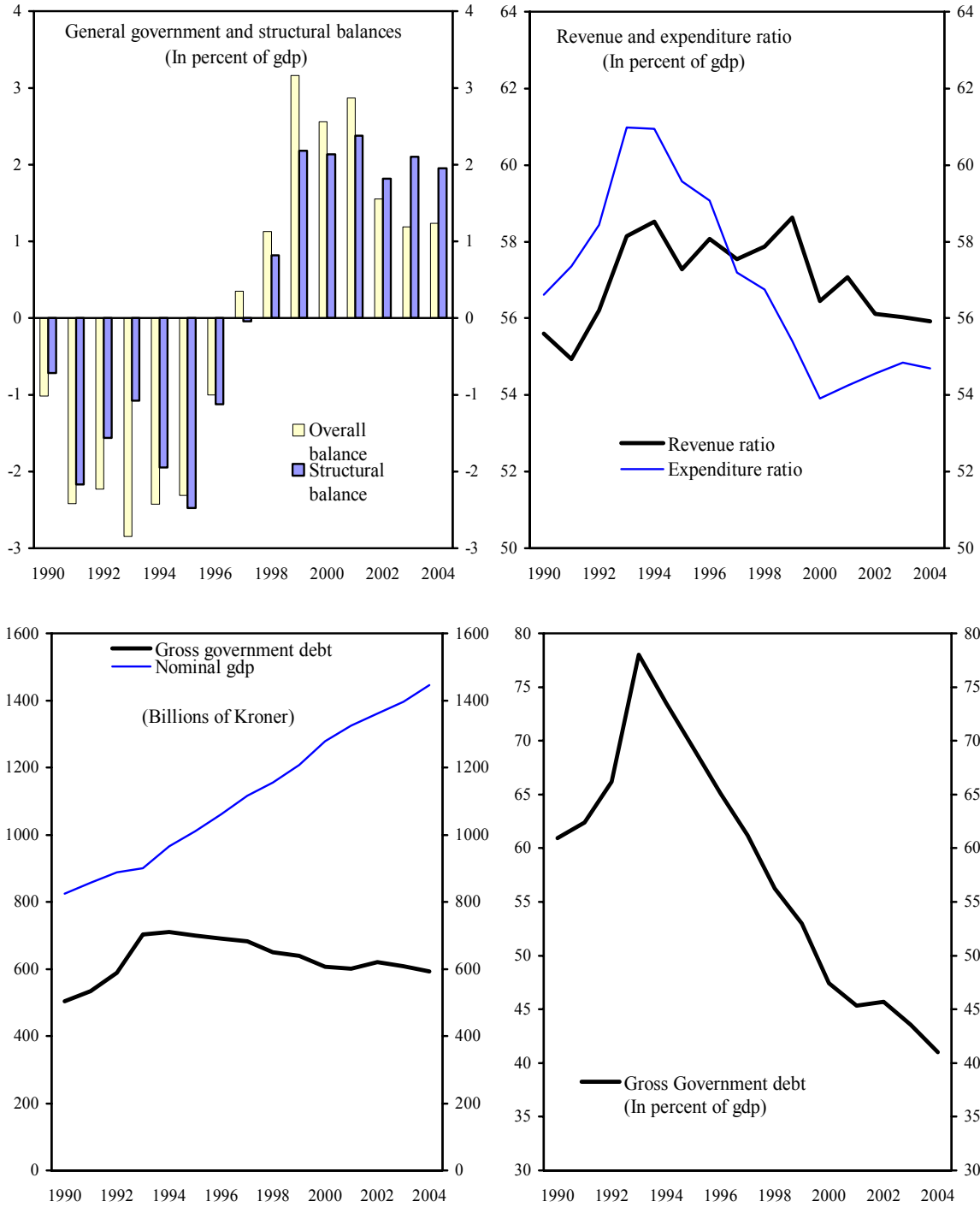
1/ Change in primary structural balance.

5. **Inflation remains well under control, helped by the longstanding fixed exchange rate of the krone.**<sup>1</sup> Headline HICP inflation is down below 1 percent, partly due to reductions in taxes on alcohol and tobacco (Figure 7). As of April, the krone has appreciated by nearly 30 percent against the dollar since the low point in 2000 and by roughly 10 percent in real effective terms putting downward pressure on import prices. Wages continued to grow in 2003 at the trend rate of roughly 4 percent, above that in most partner countries, but supported by labor productivity growth. While equity prices have recovered along with the upturn in major international markets, the long but gradual upward trend in real housing prices appears to be tapering off (Figure 8). Policy interest rates in Denmark have been adjusted simultaneously with those in the euro area, and a spread of about only 10 basis points on short-term interest rates reflects the credibility of the peg (Figures 9 and 10).

6. **Economic activity remained weak in early 2004.** Given the increasing slack in the labor market and uncertainty about the strength of the recovery, the government, using its fiscal margin of maneuver, introduced a small package of fiscal measures on March 16 (see below) to help stimulate growth. Subsequently, leading indicators have evolved positively (Figure 11).

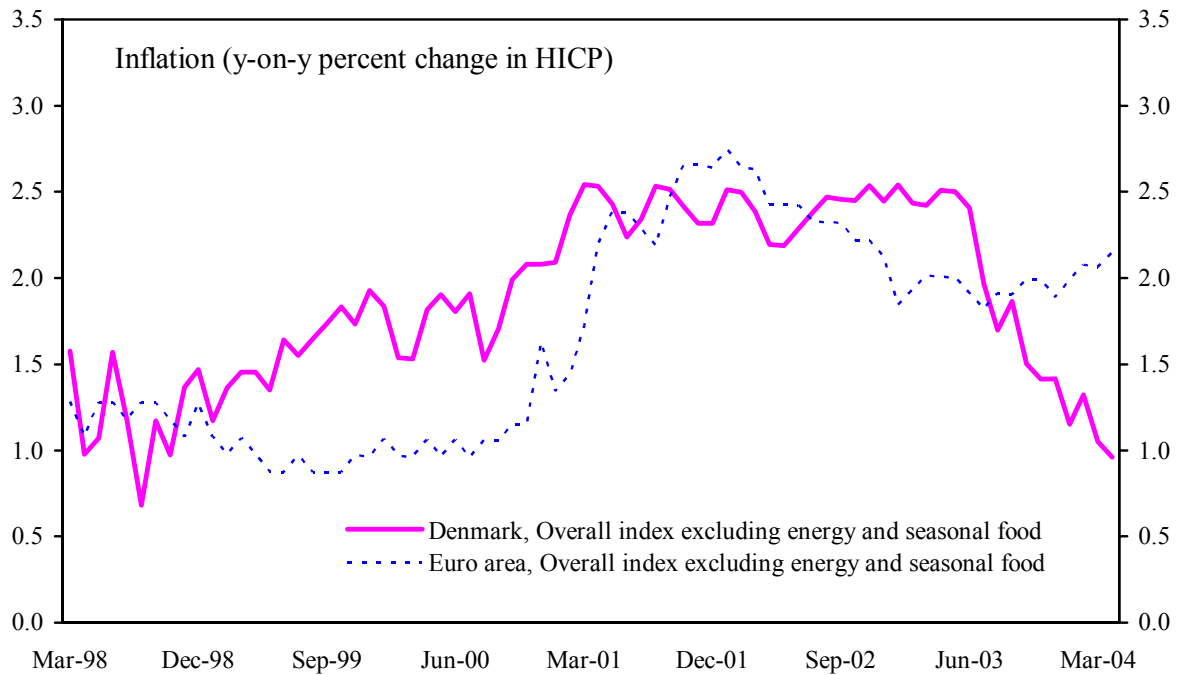
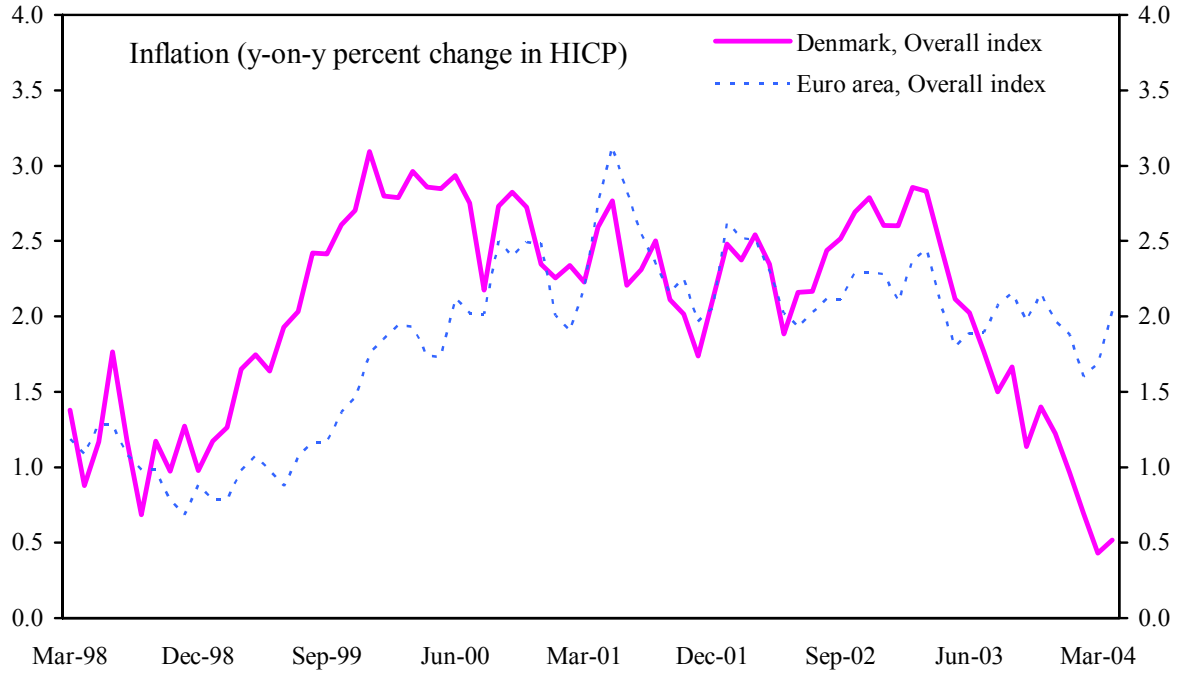
<sup>1</sup> Denmark has for some time been the sole participant in ERM II within a band of +/- 2.25 percent. In practice, the krone/euro rate has remained within about +/- 0.25 percent of the central parity.

Figure 6. Denmark: General Government, 1990–2004 1/



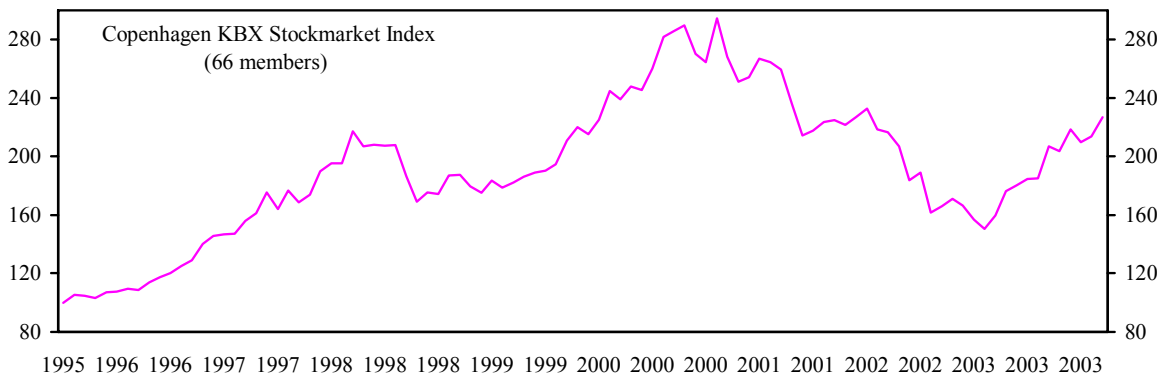
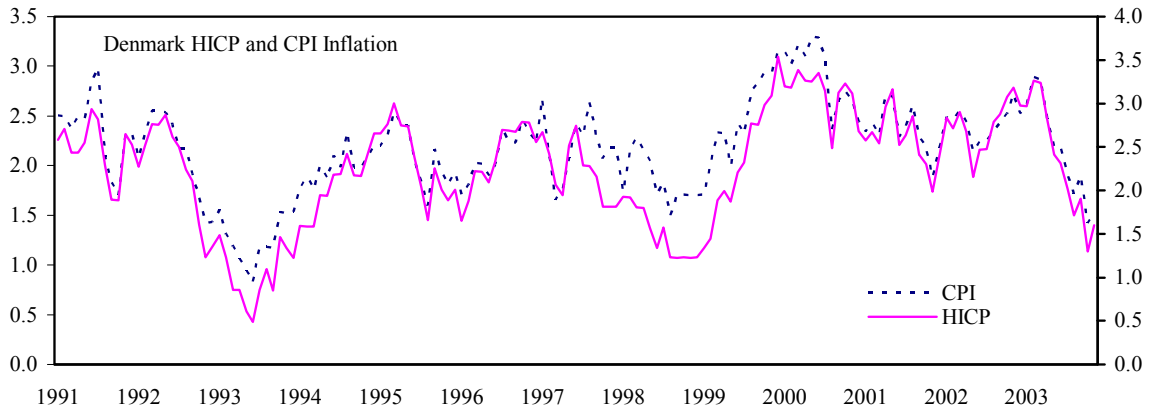
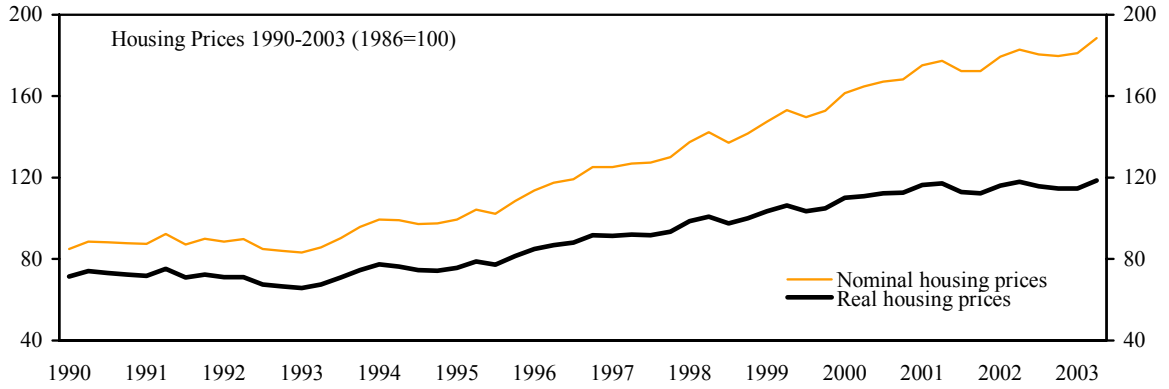
Sources: Danmarks Statistik, Ministry of Finance, staff calculations.  
 1/ Fund staff projections for 2004.

Figure 7. Denmark and the Euro Area: Inflation, 1998–2004



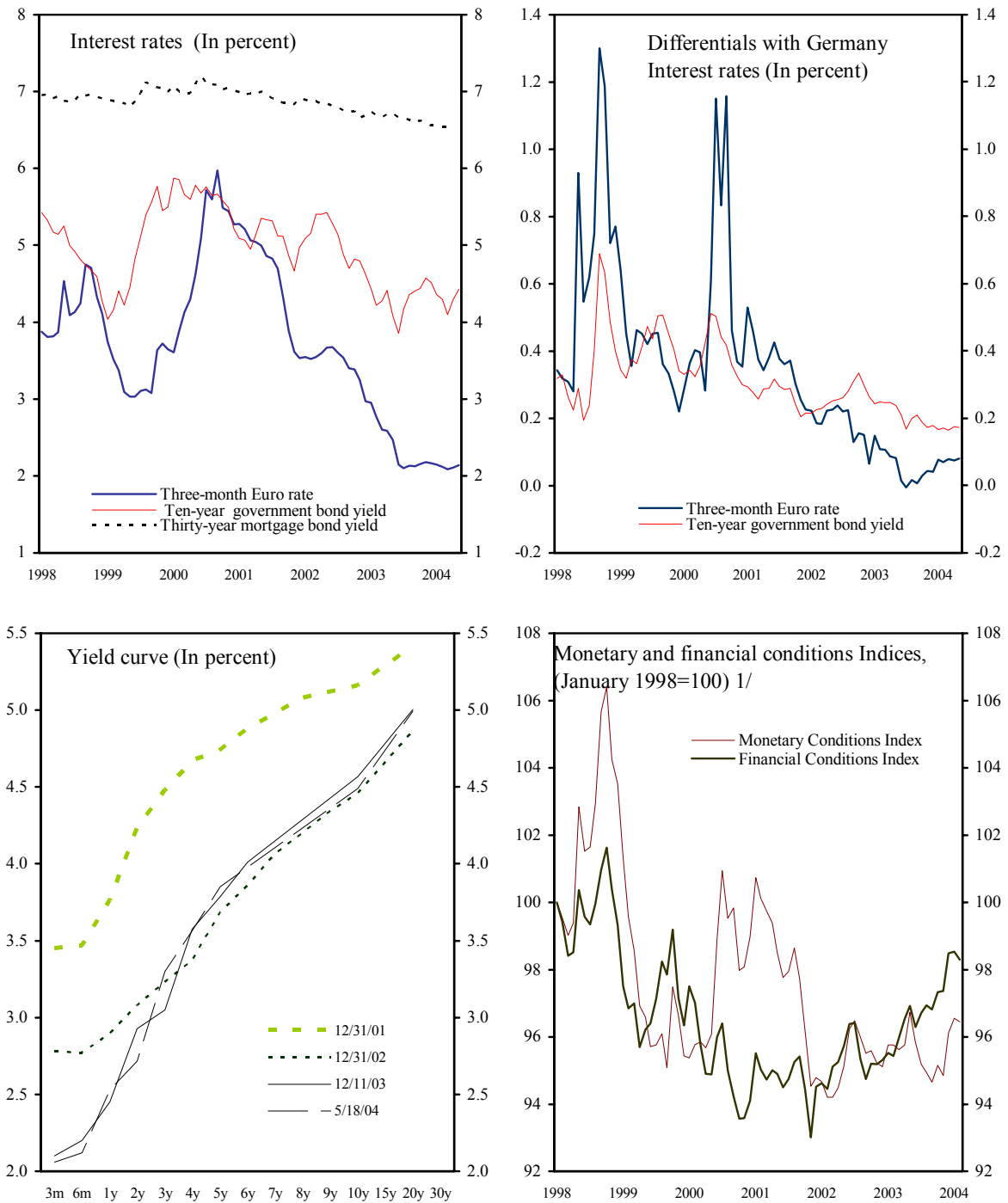
Source: EuroStat.

Figure 8. Denmark: Asset Prices and Inflation



Source: Bloomberg; and Danmarks Statistik.

Figure 9. Denmark: Interest Rates and Monetary Conditions, 1998–2004

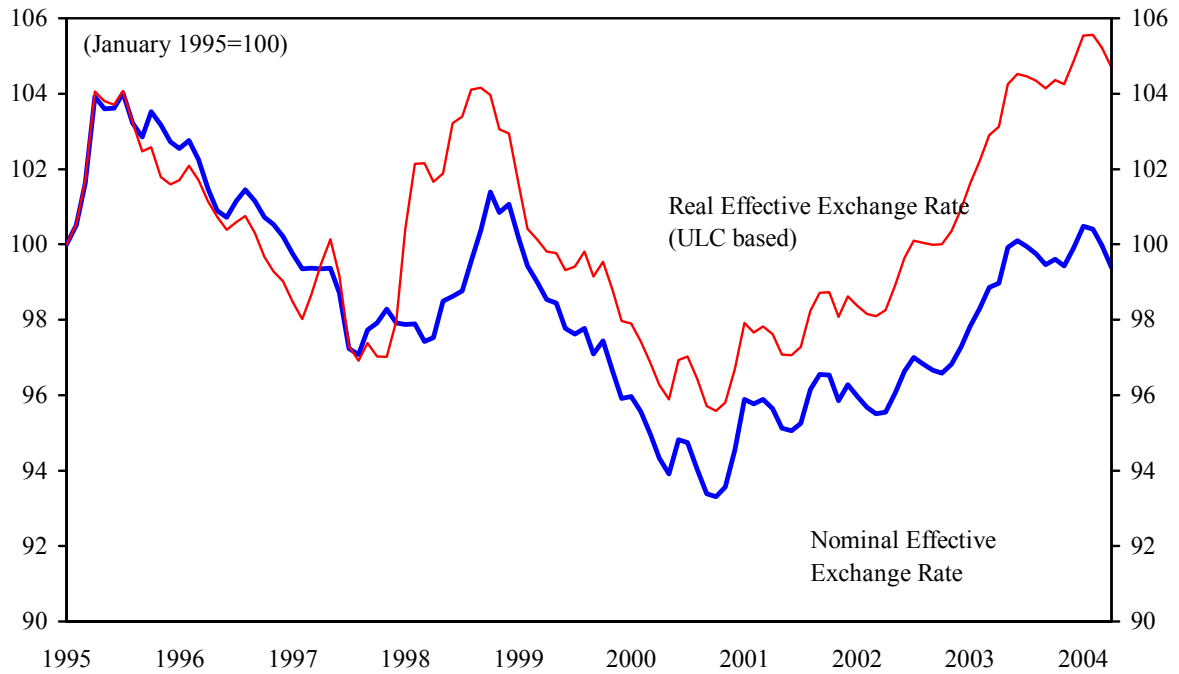
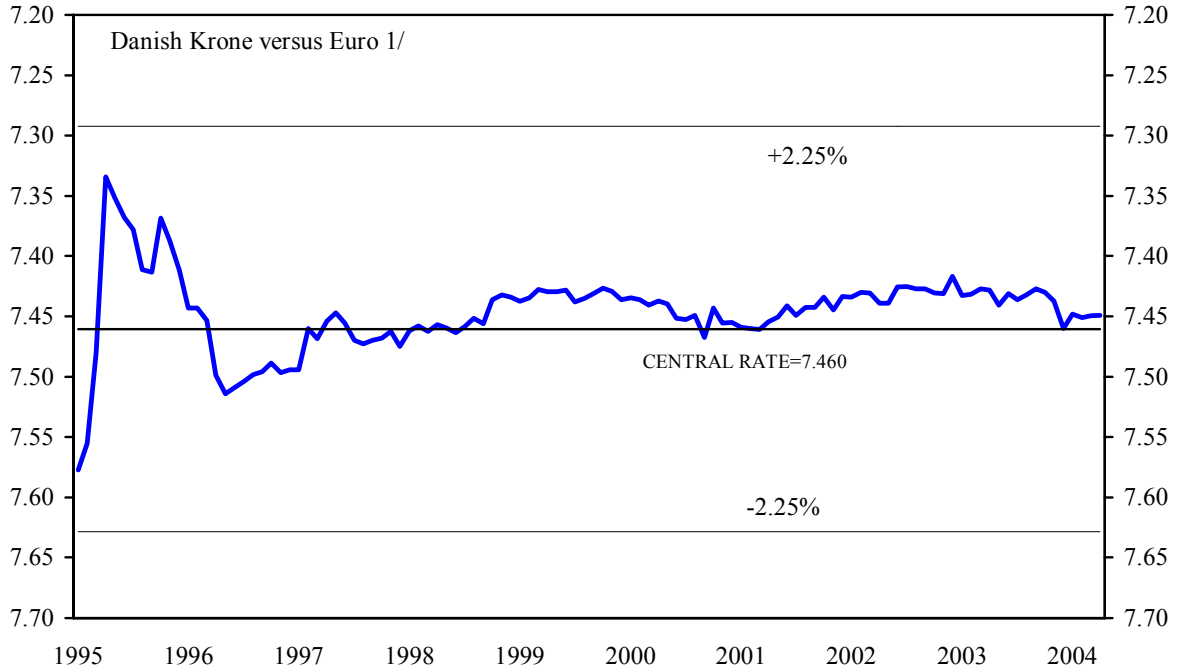


Sources: Staff estimates; and data provided by the authorities.

1/ A weighted average of deviations of interest rates (3-month for monetary conditions, and 10-year for financial conditions) and the nominal effective exchange rates from their January 1998 levels.

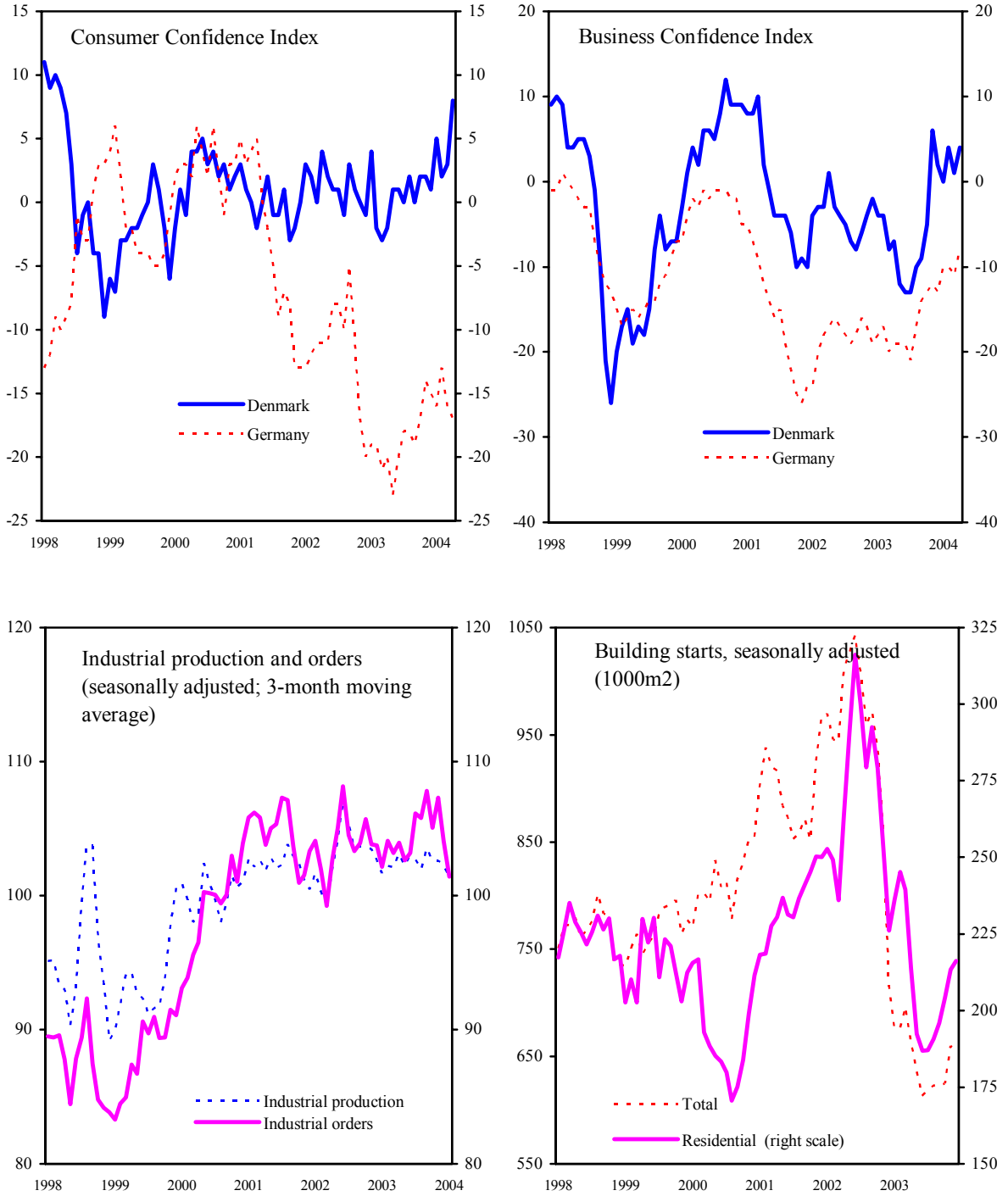


Figure 10. Denmark: Exchange Rates Developments, 1995–2004



Sources: International Financial Statistics, staff calculations.  
1/ A decline denotes depreciation.

Figure 11. Denmark: Current Economic Indicators, 1998–2004



Sources: Bloomberg; Danmarks Statistik, staff calculations; data provided by the authorities.

7. **Denmark's policies continue to be broadly in line with the Fund's recommendations in earlier consultations.** The authorities felt that Fund advice had helped to influence their thinking. In particular, Fund discussions focused on economic fundamentals with an international view, while the domestic debate is often more politically motivated. It was noted that Fund advice about overheating in the late 1990s proved to be both correct and helpful. Further, the Fund's emphasis on spending discipline and structural reform had helped generate domestic focus and build public support for the medium-term sustainability strategy.

## II. REPORT ON POLICY DISCUSSIONS

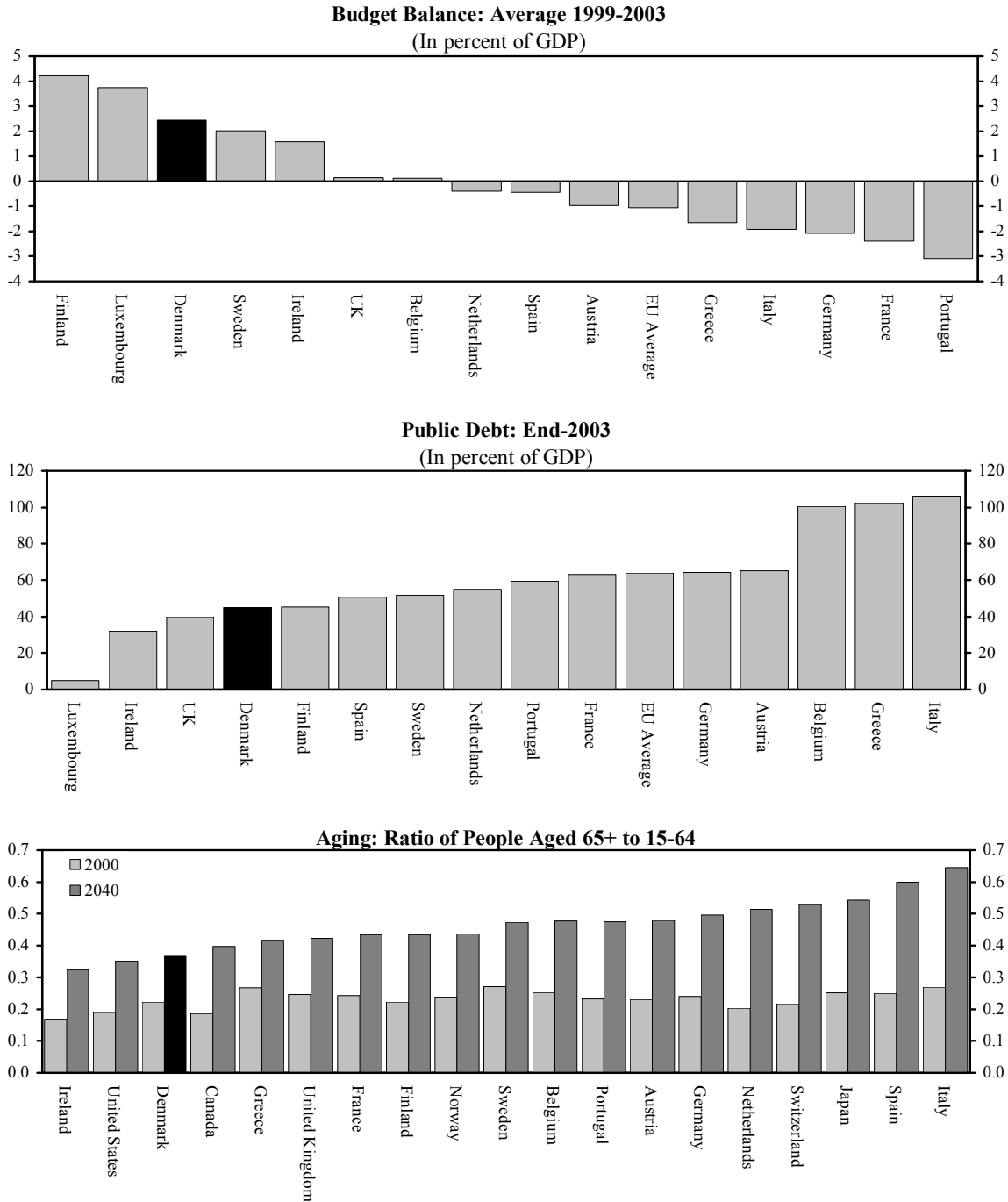
8. **The discussions focused on the near-term prospects for a return to more rapid growth and making further progress in the longer-term challenge of accommodating the fiscal pressures arising from an aging population.** Growth in Denmark has been on a slowing trend for the last three years and discussions focused on the macroeconomic fundamentals underlying the expected rebound: the stance of monetary and fiscal policy; the state of household, firm and public sector balance sheets; and Denmark's external competitiveness. Adherence to its coherent medium-term strategy, designed to ensure long-term fiscal sustainability while maintaining the welfare state without resorting to tax increases, has placed Denmark on a path with a strong fiscal position that should ensure resources will be available to fund the costs of an aging population (Figure 12). However, additional efforts will be required to achieve the medium-term employment and public expenditure targets. In this regard the discussions reviewed: the need to control public consumption expenditures; additional labor market reforms required to achieve the structural employment targets given Denmark's already high participation rates; and product market reforms required to improve overall Danish competitiveness.

### A. The Near-Term Outlook and the Policy Stance

9. **The discussions were conducted against the backdrop of the authorities' recent announcement of a stimulus package to spur growth (Box 1).** The authorities explained that the package was focused on increasing households' disposable income and consumption spending while limiting the fiscal impact. They estimated that the package could increase GDP growth in 2004 by between 0.2 and 0.5 percentage points, depending on the propensity to consume out of higher disposable income.

10. **The authorities noted that the expected pickup in world growth, accommodative monetary policy, and the stimulus from recent fiscal initiatives laid the groundwork for a return to healthy growth.** Interest rates at historical lows and the impact of the recent fiscal package were expected to support a recovery in consumption. In turn, strengthening domestic and external demand were set to sustain the emerging rebound in business confidence, stimulating investment demand. The authorities projected growth of 2.2 percent for 2004 rising to 2½ percent in 2005.

Figure 12. Denmark: Public Finances and Demographics



Source: Denmark's Statistik and United Nations

**Box 1. The Fiscal Measures Announced on March 16**

To support the economic upturn and increase employment, the government introduced a stimulus package with the following elements.

- Moving forward to 2004: (a) cuts in labor income tax rates originally planned to be phased in from 2004 to 2007; (b) social and healthcare spending; and (c) public housing construction and investment.
- A temporary suspension (in 2004 and 2005) of obligatory contributions to the Special Pension scheme (one percent of income).

In addition to these measures, the government set aside funds to strengthen efforts to educate and better qualify people for work.

The fiscal costs of the package are small since the suspension of the tax deductible obligatory pension contributions increases taxable income, offsetting the additional costs of moving forward the income tax reductions.

Fiscal Costs of the March 16 Package  
(Billions of DKr)

	2004	2005
Moving forward labor income tax cuts	3.9	2.5
Abolition of special pension savings	-3.9	-3.9
Moving forward use of social and health funds	0.6	0.0
Advancing execution of public investment	0.8	0.4
Strengthening activation and education	0.2	0.1
Total costs	1.6	-0.9

Source: Ministry of Finance

11. **The staff saw a slightly slower rebound in 2004.** The staff forecast growth to be 1.8 percent in 2004 rising to 2½ percent in 2005, with employment uncertainty and high household debt inducing households to save a larger portion of the increase in their disposable income. Further, the signals of recovery in Europe remained weak, oil prices remained high, and a resumption of euro appreciation could undermine competitiveness at a vulnerable moment. The authorities recognized the downside potential, but felt that risks were evenly balanced given the upside possibility that the fiscal stimulus, together with a more robust recovery in external and domestic demand, could engender a return to labor supply constraints within 2 years.

12. **In the staff's view, the March fiscal package would provide a counter-cyclical impetus to growth.** While the impact would be small—perhaps at the lower end of the authorities' estimate—Denmark was in a strong position to support the upturn. The package was well-designed, bringing forward needed reductions in labor income taxes and increasing incentives to work, while minimizing the short and medium-term fiscal impact. Further, relative to the pre-package stance, the measures will only have a temporary impact with the stimulus effect being largely complete by the time activity is expected to reach potential. Importantly, there was agreement that discretionary counter-cyclical fiscal interventions

should be kept as an exceptional response to avoid undermining the credibility of the medium-term targets. Staff noted that Denmark has been well-served by focusing fiscal policy on medium-term objectives, and relying on automatic stabilizers during cyclical swings.

13. **There was agreement that price inflation is likely to remain below 2 percent over the near term.** Excess capacity, reductions in indirect taxes,<sup>2</sup> and the impact on import prices of an appreciating currency have all contributed to the easing in inflationary pressures. Although the effects of the tax reductions and currency appreciation are temporary, there was agreement that capacity utilization constraints are unlikely to be reached before 2006, suggesting inflationary pressure should remain subdued. The authorities noted that the impact of labor market slack is beginning to show in wage setting as the recent central framework for wage growth sets a benchmark of 3 to 3½ percent for annual growth in labor cost over the next three years, roughly a full percentage point below the average rate of growth over the previous four years. However, most wage agreements are still to be negotiated at the local level. The authorities were aware of the risks to competitiveness should labor costs outstrip improvements in productivity. At the same time, they pointed to the sustained current account surpluses as evidence of Denmark's currently favorable external competitiveness (Box 2).

14. **On the fiscal front, the authorities and the staff project the surplus to remain broadly unchanged in 2004.** The impact of the expected pick-up in economic activity on tax revenues and current transfers will help maintain the surplus at around 1.2 percent of GDP in 2004. The expected strengthening of the recovery next year will further support public finances and the surplus is, consequently, projected to increase to around 1.4 percent of GDP in 2005 (Tables 3 and 4), below the authorities' most recent forecast of 1.7 percent of GDP.

15. **Although interest rates were judged to be appropriate given the Danish business cycle, monetary conditions have tightened due to euro appreciation.** With interest rates at historical lows, the authorities did not feel that further easing by the ECB would have much impact on domestic demand, particularly with the large baby-boom cohort focused on saving for retirement. The level of the real effective exchange rate was not viewed to be prohibitive as it was near historical averages, however, there was concern that further appreciation of the euro would undermine competitiveness.

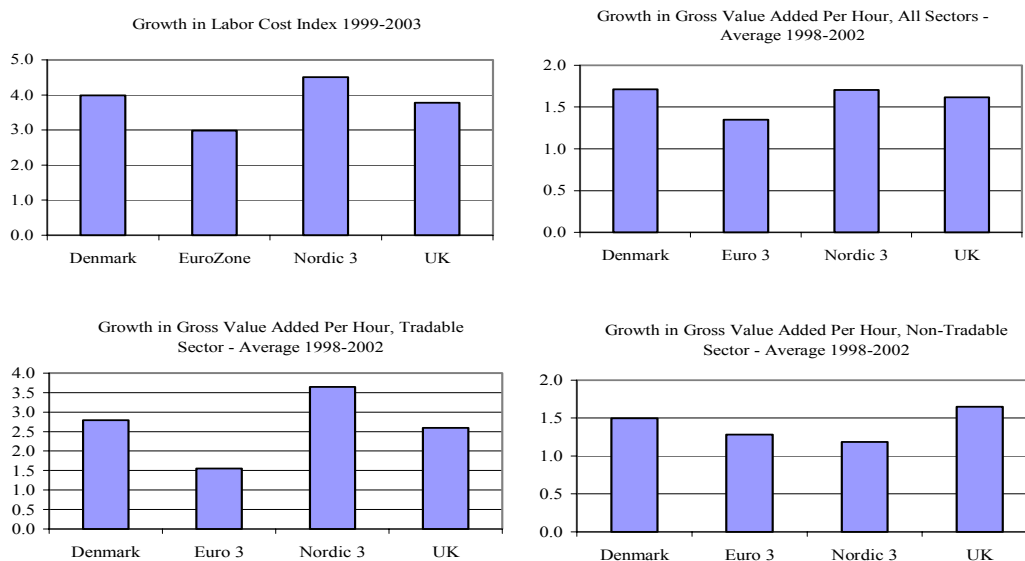
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<sup>2</sup> The reduction in alcohol and tobacco taxes that occurred October 1, 2003 contributes roughly 0.4 percentage points to the decline in year-over-year consumer price inflation.

### Box 2. Denmark's External Competitiveness

Over the last five years, the growth in Danish labor costs has consistently outpaced that in the euro area. More recently, euro appreciation has been increasing the price of Danish goods outside of the euro area. However, trade and current account balances suggest that Denmark's external competitiveness remains strong. It appears that Denmark's productivity performance relative to that of its major trading partners has helped to maintain Danish competitiveness.

Over the most recent five-year period, the growth in Danish total value added per hour has exceeded that in the three large euro area countries<sup>1</sup> and exhibited comparable performance to the three Nordic countries<sup>2</sup> and the UK. Denmark's advantage in comparison to the euro area is more pronounced in the tradable sector.<sup>3</sup> Tradable productivity growth in the three Nordic countries has been almost a full percentage point higher than in Denmark, but wage growth in these countries also exceeds that in Denmark.



Source: Ameco, EuroStat, Danmarks Statistik, Staff Calculations.

<sup>1</sup> France, Germany, and Italy.

<sup>2</sup> Finland, Norway, and Sweden.

<sup>3</sup> Comprises agriculture and industry excluding buildings and construction.

## B. The Medium-Term Strategy

16. **Considerable progress has been made in pursuing medium-term economic objectives: high and stable employment, fiscal policy sustainability, and favorable conditions for growth.** Price and exchange rate stability continue to be based on a credible commitment to a fixed exchange rate. Denmark's fiscal framework is intended to ensure that government savings over the medium term are sufficient to maintain long-term sustainability of public finances in light of population aging without having to resort to tax increases while maintaining the main elements of the welfare state (Box 3). Staff viewed the strategy as

having been appropriately designed to achieve Denmark's medium-term sustainability objectives.<sup>3</sup> The strategy calls for fiscal surpluses through 2010 that reduce public debt and free resources to accommodate the increase in spending associated with an aging population. Efforts are under way to reduce taxes, contain the growth of public expenditures, and increase growth through labor and product market reforms. Denmark has made considerable progress toward meeting its objectives: substantial fiscal surpluses continue to be realized; labor market participation rates are amongst the highest in the OECD; and structural employment has increased.

### **Box 3. Denmark's Medium-term Fiscal Framework**

Denmark began formalizing its medium-term fiscal framework in the early 1990s, with the initial impetus coming from the EU's deficit targets, debt ceilings and convergence programs. Significant further steps were taken in 1997, when the government published a more ambitious medium-term consolidation plan, *Denmark 2005*. This plan introduced objectives for debt and real public consumption growth. Later versions of the framework targeted a general government budget surplus of at least 2 percent of GDP.

In 2001 the planning horizon was extended and the government presented the current medium-term framework in *Denmark 2010*. The framework is intended to ensure that government savings over the medium term are sufficient to maintain long-term sustainability of public finances. Specifically:

- An average general government budget surplus of 1½–2½ percent of GDP over the medium term is targeted while making room for a reduction in the tax burden. The aim is to halve the government's debt-to-GDP ratio to 27½ percent by 2010.
- The framework targets real public consumption growth to 0.7 percent in 2004 and 0.5 percent thereafter.
- A tax freeze was introduced in 2002 applying to both tax rates and taxes expressed in nominal terms.
- Reductions in labor income taxes and structural reforms have been implemented, with further reforms envisaged, to achieve a 2 percent increase in structural employment by 2010.

For further information see IMF Country Report No. 02/102.

**17. There was recognition that two key elements of the strategy will be particularly challenging.** First, in the medium term, the real growth in public spending is to be held to

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<sup>3</sup>A broad range of factors contribute to the determination of the path for the fiscal balance consistent with sustainability objectives. Some of the major ones are: the initial level of government debt; the impact of aging on expenditure; the prospects for the evolution of the tax base; and the authorities' objectives for the future paths of tax rates and public services. For a detailed analysis of fiscal sustainability in Denmark see IMF Country Report No. 02/102.



0.5 percent, below the rate of GDP growth, and significantly less than the 1.6 percent average growth over the last five years. Second, the targets incorporate an increase in structural employment of 1.6 percent of the working age population, based on increasing participation rates and reducing the NAIRU to 4½ percent by 2010 from its currently estimated level of roughly 5½ percent.

### **Constraining public consumption expenditure**

18. **The authorities pointed to progress in containing the growth in public consumption expenditure, an area where slippages have occurred in the past.** To contain spending overruns, they had introduced a tax freeze and imposed legally binding rules on counties to comply with budgeted targets to have their first full-year effect in 2003. Preliminary results for 2003 pointed to progress in containing expenditure, with real public consumption growing by 0.5 percent compared to around 2 percent the previous year. Although this implied average real growth over 2002–03 in excess of the 1 percent target, staff welcomed the resulting overall strengthening of spending control.

19. **Staff cautioned that additional measures to control spending may be required.** While commending the useful check on the size of government provided by the constraints on public spending growth, the staff noted that demand for additional spending in such areas as health care will likely put pressure on the targets. Going forward, the staff recommended expressing the expenditure target in nominal rather than real terms. The staff argued that this could enhance transparency and enforceability and more directly link the target to the ultimate objective, the nominal fiscal surpluses necessary to reduce the debt ratio and secure long-term fiscal sustainability. It might also improve incentives to provide public services more cost effectively. The authorities noted that annual budgets negotiated with local authorities were set in nominal terms based on expected price developments and thereby in a sense were nominal targets. Moreover, they pointed out that it was important politically to demonstrate to the public that there would be real increases in the standards of public services.

20. **The staff recommended that user fees be considered as a means to better align demand for services with need, thereby more efficiently allocating scarce resources.** Revenue from user fees could provide room for further reductions in labor income taxes that would help achieve medium-term employment targets while maintaining the laudable objectives of the tax freeze. The authorities pointed out that the current specification of the tax freeze prevented them from implementing user fees.

21. **A reorganization of local governments is under consideration, aimed at improving delivery of public services and harnessing economies of scale.** Key questions under consideration are the size of municipalities and the division of tasks. A decision is expected before the next local elections in January 2006. The authorities noted that realized economies of scale might generate some cost savings, but they expected the largest impact would be in improved delivery of public services. An underlying tension is evident in the

process as the central government seeks to retain control over local expenditure (a large share of total spending), while local authorities feel they need more control because they are held responsible for service delivery. The authorities, cognizant of the potential spending pressures during the reform period, have imposed constraints to prevent excess capital expenditures prior to reorganization.

### **Structural reform in labor and product markets**

22. **The authorities outlined that to achieve the structural increase in employment, policy has focused on groups with relatively low participation rates: the young, older workers, and immigrants.** Attention has focused on speeding students' passage through the education system, reducing incentives for early retirement, and increasing the incentives and opportunities for recent immigrants to enter the workforce. In addition to increasing labor supply, the employment targets also embody a decline in the NAIRU to 4½ percent by 2010. A broad range of initiatives has been implemented over the last five years (Box 4) to increase structural employment and, although the authorities noted that it was still too early to judge the effectiveness of many of the initiatives, they indicated that a comprehensive monitoring program was in place.

#### **Box 4. Labor Market Initiatives Aimed at Increasing Structural Employment**

To achieve the medium-term objective of a 2 percent increase in structural employment by 2010, the government has focused on increasing the participation rates of particular groups and lowering the NAIRU. The following initiatives have been introduced:

- The number of years of tertiary education that the state fully funds has been reduced to the minimum normally required to complete the program of study.
- Incentives to postpone early retirement have been increased (1999).
- The disability pension system has been reformed to ensure that any ability to work is fully utilized.
- Long-term sickness benefit programs have been changed so that reintegration into work can occur gradually and thereby sooner to avoid marginalization. Further, financial incentives have been increased for local governments to ensure that reintegration occurs as quickly as possible.
- Social benefits have been reduced for couples that are both receiving benefits and the marginal incentives to take a job for those on social benefits have been increased by slowing the rate at which some benefits are withdrawn once employed (More People in Work, October 2002).
- Labor market activation programs have been refocused to ensure that employment and not simply participation is the goal (More People in Work, October 2002).
- For the first seven years of residence, social assistance benefits to new immigrants and repatriated Danes have been reduced to 50 to 70 percent of the level that long-term residents receive. A wage subsidy program has also been introduced for recent immigrants (The Integration Package for Immigrants, March 2003).

23. **The authorities recognized that achieving the targeted increases in labor supply will require further reforms.** Staff noted that measures to increase direct financial incentives were likely to be most effective. In particular, a reduction in the incentives for early retirement would be an important, if politically very sensitive step. The recently formed Welfare Commission is to outline the reform options and stimulate public debate.<sup>4</sup> The first report from the Commission, to be published in late May, was expected to clarify the key issues. The final report with policy options is planned for late 2005, after the elections.

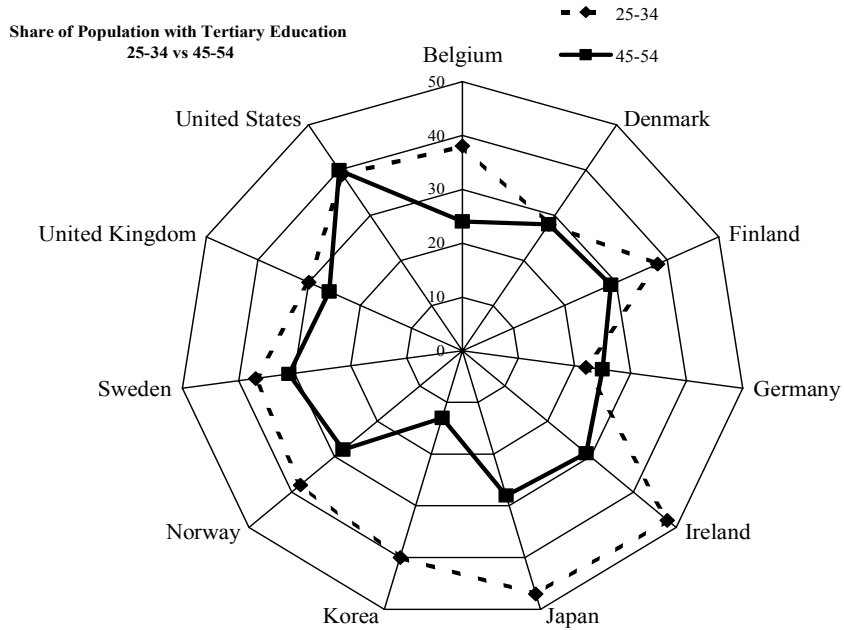
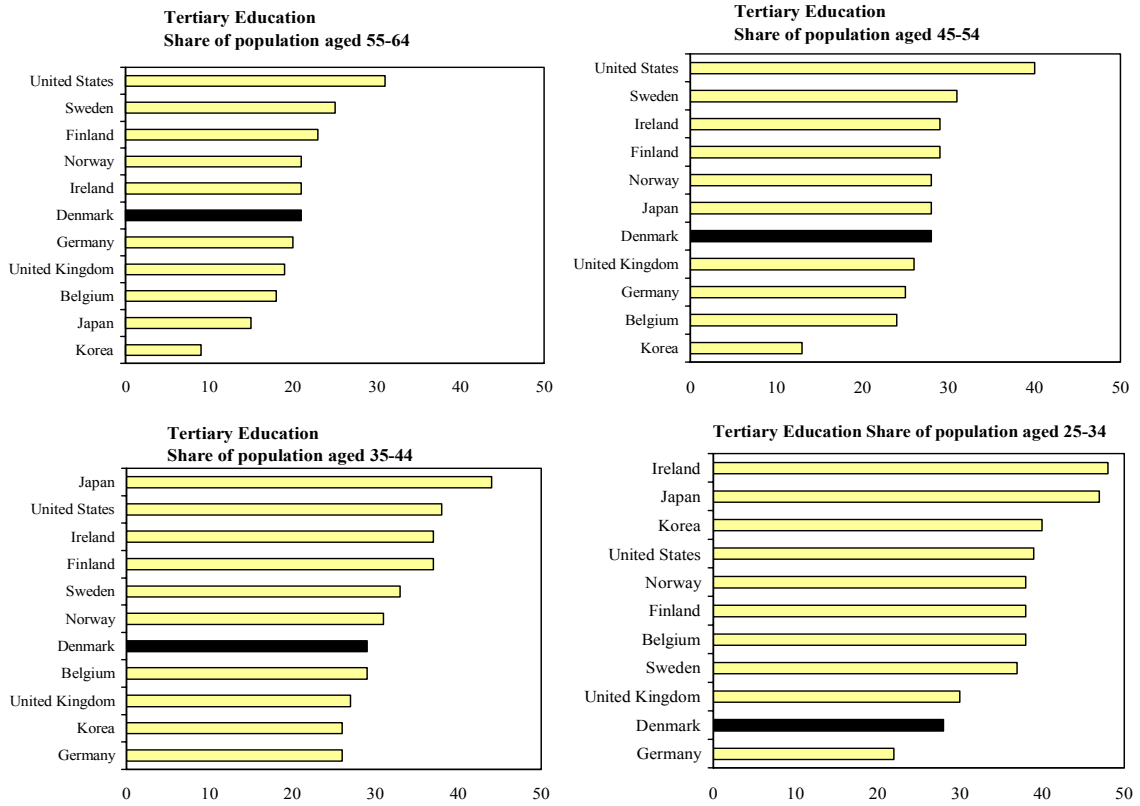
24. **The staff suggested that there was further scope to consider changes in tax and labor compensation structures to increase incentives to supply labor or invest in human capital.** Denmark has one of the highest top marginal labor income tax rates amongst the OECD and it applies to almost 40 percent of employees. Further, wage compression has long been a feature in the Danish labor market. Discussions revealed various undesirable effects stemming from tax and wage structures, such as workers' preferences for increased holidays over increased wages, some worrying trends in tertiary educational attainment in Denmark relative to other industrial countries (Figure 13), and some of the employment difficulties faced by low-skilled workers. The staff, while commending the recent progress in reducing labor income taxes, argued that efforts to reduce the top marginal rate should be pursued and that consideration should be given to allowing for greater wage dispersion. Removing the nominal tax freeze that has been imposed on some components of property taxes could provide the space to lower the top marginal tax rate, shifting the tax burden from mobile to immobile factors. While not disagreeing in principle, the authorities argued that full state funding of tertiary education and the quick pace of advancement for the highly educated helped to maintain sufficient incentives to invest in human capital. Further, the authorities indicated that the egalitarian principles underlying wage compression and the partial freezing of property taxes were very popular and would be politically difficult to change.

25. **Staff offered that increasing competition in goods markets was a necessary complement to the authorities' efforts to increase labor supply.** With the passage of legislation in 2002 increasing penalties for anti-competitive behavior, the authorities noted that Denmark's legal framework for competition policy meets the northern European standard. However, strict enforcement will be required to attain the average in practical terms. The authorities pointed to liberalization in the energy market as an indicator that progress was being made. However, it was agreed that considerable improvements were still possible particularly in construction, transportation, rental housing, and retail. Staff research using a multi-country optimizing model (the Fund's new Global Economic Model) illustrates that increasing the competitiveness in product markets would increase labor demand and help achieve the structural employment targets (Box 5 and Selected Issues (SM/04/218)).

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<sup>4</sup> The Welfare Commission is to outline reform options for the welfare system in the face of the challenges from aging.

Figure 13. Cross-Country Trends in Tertiary Education



Source: OECD

### Box 5. Estimated Impact of Regulatory Reform in Denmark and the Euro Area

The European Council's Lisbon agenda sets out an ambitious schedule for regulatory reform in labor and goods markets so that European countries can exploit all the opportunities of globalization and the information technology revolution to achieve their full potential in terms of employment and productivity growth. In goods markets, excessive regulation can reduce employment and slow productivity growth if it constrains competition and allows firms to keep output too low thereby keeping prices too high. Among others, regulations such as import licensing, quotas, product standards, public and private monopolies, administrative burdens and access to capital all help to determine the extent to which firms can constrain output and keep prices too high. In labor markets, the regulatory environment can lower employment and output if it allows workers to constrain the supply of labor available to firms, thereby keeping real wages artificially high. The amount of power that workers have to reduce the labor supply and artificially drive up the real wage depends on factors such as minimum wage legislation, the generosity of unemployment insurance and welfare benefits, legislation that influences unionization and the wage bargaining process, and immigration policy.

The IMF's new Global Economic Model (GEM) has been used to estimate the benefits of regulatory reform that increases competition in goods and labor markets. The analysis suggests that if the levels of goods and labor market efficiencies in Denmark and the euro area increased to match the levels estimated to be the best among industrial countries, then real GDP will increase in the long-run by roughly 7 percent in Denmark and 12 percent in the euro area. Although the empirical estimates suggest that Denmark needs to undertake less reform than the euro area on average, the benefits in Denmark are still quite large because of positive spillovers from the reform undertaken in the euro area, Denmark's major trading partner. The increase in real GDP resulting from more efficient labor and product markets comes from an increase in the capital stock and an increase in hours worked. The results, although dependent on model calibration, are consistent with that Danish government's medium-term target of an increase in structural employment of 2 percent. However, the results suggest that both labor and product market reforms will be required. For further details see Denmark: Selected Issues (SM/04/218).

Impact of Regulatory Reform in Denmark and the Euro Area  
(Percent deviation from baseline)

	5 years	10 years	Long run
<b>Denmark</b>			
GDP	2.50	4.58	6.89
Hours worked	1.72	2.36	3.12
Capital stock	2.73	6.32	11.16
<b>Euro Area</b>			
GDP	4.48	8.34	11.76
Hours worked	4.34	5.95	7.36
Capital stock	4.68	13.36	21.67

Source: IMF's Global Economic Model simulations in upcoming Selected Issues Paper.

## C. Exchange Rate and Financial Sector

26. **The authorities viewed Denmark's fixed exchange rate in ERM II as a central pillar of their framework for macroeconomic stability and noted that it had served the country well.** The commitment to the fixed exchange rate has been the central element underlying the evolution of macroeconomic policy for the last two decades and the staff

agreed with the authorities' positive assessment of its role. Inflation has been low and stable, and fiscal policy has been focused on ensuring that fundamental savings and investment balances in Denmark are consistent with the peg. The authorities noted that the success of the fixed exchange rate was partly due to Denmark's historical experience, and as such not necessarily replicable elsewhere. The poor macroeconomic outcomes in the 1970s and early 1980s served to build public support for the policies that were required over the subsequent decades to sustain the peg. In particular, the historical experience helped build support for prudent fiscal policy focused on medium-term objectives, reforms to make the economy more flexible, and unhesitating use of interest rates to defend the peg when necessary. Eventual euro adoption continues to be the authorities' favored exit strategy, but this has not received the necessary support from a population concerned about loss of sovereignty. A referendum on joining the euro was rejected by a small margin in 2000 and another is unlikely to take place at least until after the next elections.

27. **Despite the three-year slowdown, the quality of banks' assets remain high and loan losses have been minimal (Table A3).** Some debtors, notably in the agricultural sector, have come under some stress, but the share of such loans is small and authorities saw no systemic concerns. The authorities conduct periodic stress tests and these suggested that while there was some dispersion among banks, there were sufficient buffers to absorb significant risks in the banking system. Denmark has requested an FSAP that is now planned to take place in late 2005 in the context of next Article IV consultation cycle.

28. **Insurance companies and pension funds benefited from the favorable performance of equity markets in 2003.** Solvency ratios remained healthy, and the authorities considered that the potential for systemic problems was extremely limited. The risks related to liabilities linked to interest guarantees have to a high degree been hedged through various financial instruments.

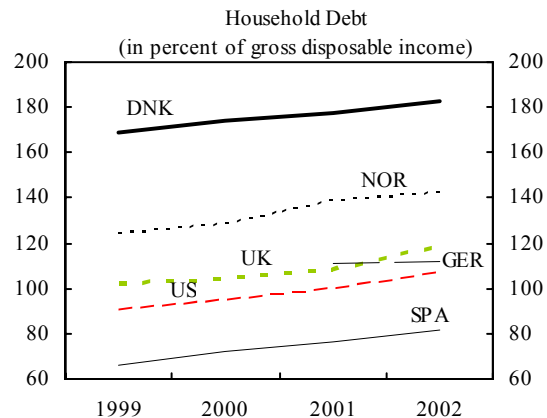
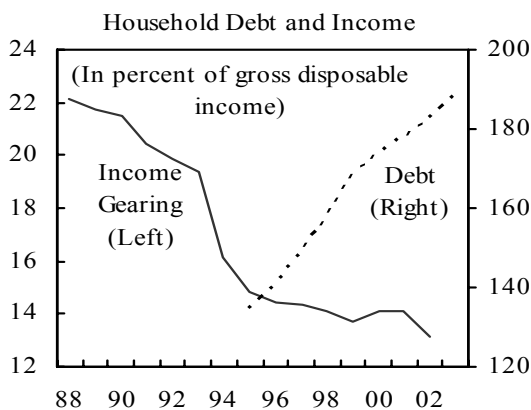
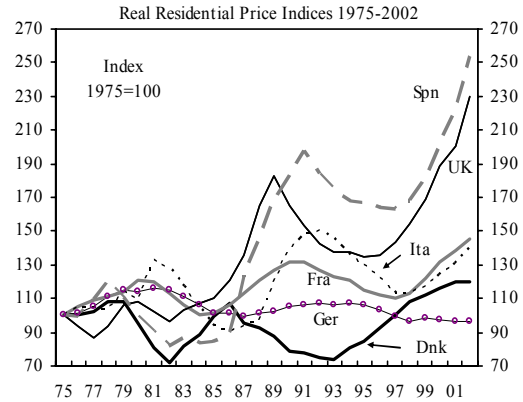
29. **There was agreement that the risks from rising house prices and household debt levels appear contained.** The increase over recent years in household indebtedness, particularly mortgage debt, and the wider use of adjustable-rate mortgages have increased households' exposure to changes in short-term interest rates. While household debt is high by international standards, the authorities noted that debt-servicing costs remain quite low because of low interest rates. Furthermore, net debt is lower in Denmark as household assets are substantial, partly a reflection of high home values. While housing prices have been on a ten-year rising trend, the increase remains well below that in some other countries (Box 6).

30. **The authorities recognized that further euro area integration of the financial sector presents challenges for supervision.** They were fully cognizant of the importance of regulatory harmonization in the context of increasing conglomeration and cross-border mergers. One large Danish bank is merging its subsidiaries across the Nordic region into a single bank chartered in Sweden, and will operate in Denmark as a systemically-important branch. Cross-border cooperation will be enhanced by the adoption of the EU's financial services directive and Basel II accord. However, the authorities noted that the new regulations

would effectively imply a loosening of provisioning and capital adequacy requirements for Danish banks. The authorities were encouraging domestic banks to move gradually to the new lower levels of capital adequacy, although they were aware of the competitive pressures.

### Box 6. House Prices and Household Debt

- Denmark has experienced three episodes of strong house price gains since the mid-1970s. The last episode since 1993 has been the longest expansion, with real house prices rising by over 5½ percent a year. The steady rise reflects in part an increase in the demand for houses associated with a reduction in mortgage interest rates and greater access to credit.
- During this period, household debt has increased steadily as homeowners have shifted to mortgage secured loans to repay bank debt taking advantage of lower interest rates of mortgage credits. Household income gearing—the ratio of interest payments to disposable income—remains low by historical standards, reflecting low interest rate levels, but household exposure to changes in short-term interest rates has increased.
- Compared to other countries, the household debt, as a ratio of gross disposable income, appears high, but debt as a ratio of owner occupied housing prices has remained fairly stable. Among the debtors, limited micro data showed that the mostly liquidity constrained amounted to roughly 30–40 percent of total households.



#### **D. Statistical and Other Issues**

31. **Denmark has consistently supported trade liberalization within the context of EU membership.** Staff welcomed the authorities' intention to press for resuming negotiations under the Doha round. The authorities also reiterated their support for CAP reform and the EU's flexibility on the "Singapore issues" (investment, competition, government procurement, and trade facilitation).

32. **Denmark subscribes to the SDDS and its economic data coverage is comprehensive.** The gap between exports based on trade data (Danmarks Statistik) and exports based on balance of payments data (Danmarks Nationalbank) has widened in recent years and ongoing discussions between the two organizations have not as yet led to a reconciliation of the two series.

33. **Denmark maintains its leadership in development assistance and the staff encouraged the continuation of this policy in the future.** Although aid as a share of gross national income has fallen slightly in recent years, the staff commended the policy of maintaining development assistance at a level representing at least 0.7 percent of gross national income—still among the highest of any country.

34. **Denmark has adopted the OECD's anti-bribery convention and has satisfied the 40 Financial Action Task Force (FATF) recommendations in the area of money laundering.** Denmark has completed the questionnaire on anti-money laundering and the financing of terrorism. Based on their response and discussions held during the Article IV consultation, the AML/CLFT regime appears to have a solid foundation.

#### **III. STAFF APPRAISAL**

35. **A decade of successful structural reform and prudent fiscal management put Denmark in a strong position to weather the recent world-wide economic slowdown.** Labor market reforms commencing in the mid 1990s resulted in a significant increase in structural employment that helped fuel a sustained period of robust economic growth leaving households and firms with balance sheets capable of withstanding the recent slowdown in growth. Over the same period, prudent fiscal management, formalized in a medium-term framework for achieving sustainability in public finances, resulted in fiscal surpluses and a significant reduction in government debt as a share of GDP. However, key challenges remain in Denmark's quest to maintain the key elements of the welfare state and ensure long-term fiscal sustainability without increasing taxes.

36. **Conditions for a return to healthy growth appear to be in place.** Accommodative fiscal and monetary policy, healthy balance sheets, favorable external competitiveness and several leading indicators point to a resumption of growth that is close to the economy's potential. Household sector employment concerns and possible weakness in trading partner



demand appear to be the key downside risks, while the risk of a sharp retrenchment in house prices undermining the recovery appears low.

37. **The package of fiscal measures introduced by the government in March is expected to provide a helpful impetus to the current recovery without undermining medium-term objectives.** However, to maintain the momentum to address the remaining medium-term issues, it is important to avoid generating the expectation that fiscal fine tuning will become a regular tool for short-run stabilization.

38. **Denmark has already made considerable progress in preparing for the fiscal pressures from aging and medium-term sustainability continues to be the appropriate policy focus.** Although recent developments suggest some progress has been made in reducing public consumption growth, containing it remains a cornerstone of the medium-term strategy. Consideration should be given to specifying spending targets in nominal terms. Increasing healthcare costs, above and beyond the volume effects from an aging population, represent a key risk to the containment of public consumption expenditures. Introducing user fees should be considered to more efficiently allocate scarce healthcare resources and contain demand pressures. Further, revenues from user fees could provide the fiscal room to achieve other labor market objectives while respecting, in aggregate, the tax freeze.

39. **Given Denmark's high overall participation rate, achieving the targeted increases in structural employment may require politically difficult measures.** The authorities are appropriately focusing on the sectors of the labor market where participation rates are low, including both the older and younger age groups and first- and second-generation immigrants.

40. **Achieving substantial increases in medium-term employment will likely require changes to early retirement schemes.** The time profile for participation among the elderly indicates that early retirement schemes have been the key reason for the decline in participation of this group. While changes to the system of early retirement incentives will not be easy politically, they could have a more rapid impact on employment than other areas where improvements are likely to be more gradual.

41. **Further reductions in labor income taxes should be considered.** Demographics are shrinking the relative size of the working age population, and policy should be focused on reducing the extent to which the structure of the tax system constrains labor supply. Labor income taxes in Denmark continue to be amongst the highest in the OECD and there are some worrying signals that this may be undermining incentives to invest in human capital.

42. **Denmark's fixed exchange rate system remains a cornerstone of the economic strategy.** It has served the country well as an anchor for expectations, and an effective discipline on fiscal and other economic policies. The low spreads in interest rates vis-à-vis the euro attest to the credibility of the peg.

43. It is proposed that the next Article IV consultation be conducted on the 24-month cycle.

Table 1. Denmark: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 proj.
Real economy (change in percent) 1/							
Real GDP	2.5	2.6	2.8	1.6	1.0	0.4	1.8
Net Exports 2/	-1.4	2.6	0.5	0.6	-0.8	0.3	-0.4
Final Domestic demand	4.2	1.2	1.4	1.8	2.0	0.6	2.3
Private consumption	2.3	0.7	-0.7	-0.2	0.6	1.1	3.0
Gross fixed investment	10.1	1.5	6.9	4.9	4.5	-0.4	2.5
Residential buildings	4.2	-1.0	7.7	-5.3	10.5	7.8	3.0
Gross national saving (percent of GDP)	20.8	21.9	24.0	24.4	22.8	22.5	22.0
Gross domestic investment (percent of GDP)	21.7	19.7	21.0	20.5	20.8	19.6	20.1
Labor force	0.3	0.4	0.4	0.4	-0.3	-0.4	0.5
Employment	1.7	1.3	0.7	0.6	-0.4	-1.3	0.3
Unemployment rate (in percent)	6.4	5.5	5.1	4.9	4.9	5.8	6.0
Unit labor cost (manufacturing)	1.9	0.3	-1.7	2.1	1.0	3.2	1.3
GDP deflator	1.0	1.8	3.0	2.1	1.6	2.1	1.6
CPI (year average)	1.8	2.5	2.9	2.4	2.3	2.1	1.7
Public finance (percent of GDP) 1/							
General government revenues 3/	57.9	58.6	56.5	57.1	56.1	56.0	55.9
General government expenditure	56.7	55.4	53.9	54.2	54.6	54.8	54.7
General government balance	1.1	3.2	2.5	2.8	1.6	1.2	1.2
General government structural balance	0.8	2.2	2.1	2.4	1.6	2.1	2.0
General government debt	56.2	53.0	47.4	45.4	45.7	43.3	41.7
Money and credit (end of year, percent change)							
Domestic credit 4/	9.4	5.8	11.4	9.5	5.1	6.3	...
M3	2.9	4.1	2.0	8.0	10.7	12.5	...
Interest rates (percent)							
Money market rate 5/	4.2	3.3	4.9	4.6	3.5	2.4	2.1
Government bond yield 5/	4.9	4.9	5.7	5.1	5.1	4.3	5.0
Balance of payments (In billions of DKr., unless otherwise noted)							
Exports	322.0	347.5	405.3	419.8	436.3	428.9	442.3
Imports	-296.7	-300.8	-351.1	-358.1	-376.2	-362.1	-385.3
Merchandise trade balance (f.o.b.)	25.3	46.7	54.1	61.7	60.1	66.8	57.1
Current account (percent of GDP)	-0.9	1.8	1.5	3.1	2.0	3.0	1.8
Exchange rate							
Exchange rate regime	Participant in ERM2						
Present rate (May 19, 2004)	Danish Kroner 6.206 per US\$1						
Nominal effective exchange rate (1995=100)	96.5	95.4	91.9	93.3	93.8	96.7	...
Real effective exchange rate (1995=100) 6/	97.4	97.2	94.2	95.6	97.0	101.3	...

Sources: IMF, International Financial Statistics; IMF, World Economic Outlook; and staff projections.

1/ Staff estimates.

2/ Contribution to GDP growth.

3/ Fiscal revenues and financial balance from 2002 reduced by 0.5 percent of GDP due to a transfer of pensions to private sector.

4/ Lending growth for banks and mortgage institutions.

5/ Data for 2004 refer to April 2004.

6/ Based on relative normalized unit labor cost in manufacturing.

Table 2. Denmark: Balance of Payments

	1998	1999	2000	2001	2002	2003
(In billions of DKr.)						
<b>Current account balance</b>	<b>-10.2</b>	<b>21.2</b>	<b>18.6</b>	<b>40.5</b>	<b>27.7</b>	<b>40.5</b>
Trade balance of goods	25.3	46.7	54.1	61.7	60.1	66.8
Exports of goods (fob)	322.0	347.5	405.3	419.8	436.3	428.9
Imports of goods (fob)	296.7	300.8	351.1	358.1	376.2	362.1
Services (net)	-2.0	11.1	22.1	25.0	18.1	24.8
Exports of services	101.7	139.6	192.6	209.2	209.8	211.1
Imports of services	103.6	128.5	170.5	184.2	191.6	186.2
Income (net)	-18.4	-17.4	-32.8	-25.0	-27.5	-26.1
Compensation of employees (net)	3.0	0.8	0.1	-0.4	-0.6	-0.6
Investment income (net)	-21.3	-18.1	-32.9	-24.6	-26.9	-25.5
Current transfers	-15.2	-19.3	-24.8	-21.3	-23.0	-25.1
From EU (net)	-3.4	-2.0	-3.7	-2.8	-5.6	-5.0
Other current transfers	-11.8	-17.3	-21.1	-18.5	-17.4	-20.1
<b>Capital accounts</b>	<b>-0.6</b>	<b>7.7</b>	<b>-0.1</b>	<b>-0.2</b>	<b>0.7</b>	<b>-0.3</b>
<b>Financial accounts 1/</b>	<b>10.8</b>	<b>-28.9</b>	<b>-18.5</b>	<b>-40.2</b>	<b>-28.5</b>	<b>-40.2</b>
FDI net	16.9	-6.8	59.4	-25.2	13.7	9.5
Portfolio investment net	-64.9	-22.6	-147.1	-35.3	1.0	-117.7
Financial derivatives	0.0	2.3	2.9	5.8	3.4	-0.7
Other investment net 1/	29.6	62.5	23.4	42.0	-1.1	99.5
Change in reserve assets (- increase)	29.2	-64.2	43.0	-27.5	-45.4	-30.8
<b>Current account balance</b>	<b>-0.9</b>	<b>1.8</b>	<b>1.5</b>	<b>3.1</b>	<b>2.0</b>	<b>2.9</b>
Trade balance of goods	2.2	3.9	4.2	4.7	4.4	4.8
Exports of goods (fob)	27.9	28.8	31.7	31.7	32.1	30.7
Imports of goods (fob)	25.7	24.9	27.5	27.0	27.6	25.9
Services (net)	-0.2	0.9	1.7	1.9	1.3	1.8
Exports of services	8.8	11.6	15.1	15.8	15.4	15.1
Imports of services	9.0	10.6	13.3	13.9	14.1	13.3
Income (net)	-1.6	-1.4	-2.6	-1.9	-2.0	-1.9
Compensation of employees (net)	0.3	0.1	0.0	0.0	0.0	0.0
Investment income (net)	-1.8	-1.5	-2.6	-1.9	-2.0	-1.8
Current transfers	-1.3	-1.6	-1.9	-1.6	-1.7	-1.8
From EU (net)	-0.3	-0.2	-0.3	-0.2	-0.4	-0.4
Other current transfers	-1.0	-1.4	-1.7	-1.4	-1.3	-1.4
<b>Capital accounts</b>	<b>-0.1</b>	<b>0.6</b>	<b>0.0</b>	<b>0.0</b>	<b>0.1</b>	<b>0.0</b>
<b>Financial accounts 1/</b>	<b>0.9</b>	<b>-2.4</b>	<b>-1.4</b>	<b>-3.0</b>	<b>-2.1</b>	<b>-2.9</b>
FDI net	1.5	-0.6	4.6	-1.9	1.0	0.7
Portfolio investment net	-5.6	-1.9	-11.5	-2.7	0.1	-8.4
Financial derivatives	0.0	0.2	0.2	0.4	0.3	-0.1
Other investment net 1/	2.6	5.2	1.8	3.2	-0.1	7.1
Change in reserve assets (- increase)	2.5	-5.3	3.4	-2.1	-3.3	-2.2

Source: Danmarks Statistik.

1/ Includes errors and omissions.

Table 3. Denmark: Medium-Term Forecast 2002–09

	2002	2003	2004 1/	2005	2006	2007	2008	2009
Real economy (change in percent) 2/								
Real GDP	1.0	0.4	1.8	2.5	2.3	2.1	1.9	1.9
Net Exports 3/	-0.8	-0.1	-0.4	-0.7	-0.2	0.0	0.0	-0.3
Final Domestic demand	2.0	0.6	2.3	3.3	2.5	2.2	2.0	2.3
Private consumption	0.6	1.1	3.0	4.3	2.9	2.2	1.9	2.5
Public consumption	2.1	0.5	0.7	0.6	0.6	0.6	0.6	0.6
Gross fixed investment	4.5	-0.4	2.5	4.2	3.8	3.5	3.4	3.3
Residential buildings	10.5	7.8	3.0	4.0	3.5	3.5	3.5	3.5
Gross national saving (percent of GDP)	22.8	22.5	22.0	22.2	22.6	23.1	23.6	23.8
Gross domestic investment (percent of GDP)	20.8	19.6	20.1	20.6	21.0	21.3	21.7	22.0
Labor force	-0.3	-0.4	0.5	0.3	0.3	0.3	0.3	0.3
Employment	-0.4	-1.3	0.3	0.6	0.8	0.4	0.4	0.4
Unemployment rate (in percent)	4.9	5.8	6.0	5.6	5.2	5.1	5.0	5.0
Unit labor cost (manufacturing)	1.0	3.2	1.3	1.1	1.4	1.9	2.3	2.4
GDP deflator	1.6	2.1	1.6	1.6	1.7	2.1	2.2	2.2
CPI (year average)	2.3	2.1	1.7	1.8	2.0	2.0	2.0	2.0
Public finance (percent of GDP) 2/								
General government revenues	56.1	56.0	55.9	55.8	55.9	55.7	55.5	55.2
General government expenditure	54.6	54.8	54.7	54.4	54.2	53.8	53.6	53.3
General government balance	1.6	1.2	1.2	1.4	1.7	1.9	1.9	1.9
General government structural balance	1.6	2.1	2.0	1.8	1.7	1.8	1.9	1.9
General government debt	45.7	43.3	41.7	39.6	37.3	35.0	32.7	30.5
Interest rates (percent)								
3-month interbank rate	3.7	4.1	4.5	4.9	5.2	5.2	5.2	5.2
Government bond yield	5.1	4.3	5.0	5.1	5.2	5.2	5.2	5.2
Balance of payments (In billions of DKr., unless otherwise noted)								
Exports	436.3	428.9	442.3	465.7	496.5	530.7	565.2	600.2
Imports	-376.2	-362.1	-385.3	-411.1	-440.9	-472.7	-505.1	-540.6
Merchandise trade balance (f.o.b.)	60.1	66.8	57.1	54.6	55.6	58.0	60.1	59.6
Current account (percent of GDP)	2.0	3.0	1.8	1.5	1.5	1.7	1.8	1.6
Exchange rate								
Exchange rate regime								
Present rate (April 3, 2002)								
Nominal effective exchange rate (1995=100)	93.8	96.7	...	...	...	...	...	...
Real effective exchange rate (1995=100) 4/	97.0	101.3	...	...	...	...	...	...

Sources: IMF, International Financial Statistics; IMF, World Economic Outlook; and staff projections.

1/ Staff projections for 2004-2009.

2/ Preliminary estimates by staff for 2003.

3/ Contribution to GDP growth.

4/ Based on relative normalized unit labor cost in manufacturing.

Table 4. Denmark Public Finance  
(In percent of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
	Actual	Actual	Actual	Prelim.	Staff	Staff	Staff	Staff	Staff	Staff
Total Expenditures	53.9	54.2	54.6	54.8	54.7	54.4	54.2	53.8	53.6	53.3
Public Consumption'	25.3	25.9	26.3	26.5	26.5	26.5	26.4	26.3	26.3	26.2
Transfer Incomes	17.3	17.3	17.5	18.1	18.2	18.1	18.1	18.0	18.0	18.0
Public Subsidies	2.2	2.2	2.2	2.2	2.1	2.1	2.1	2.1	2.1	2.1
Interest Expenditures	4.3	4.0	3.7	3.4	3.2	3.0	2.9	2.7	2.6	2.4
Public Investment	1.7	1.8	1.8	1.6	1.8	1.7	1.7	1.7	1.7	1.7
Other Expenditures	3.1	3.1	3.0	3.0	2.9	2.9	2.9	2.9	2.9	2.9
Total Revenues	56.5	57.1	56.1	56.0	55.9	55.8	55.9	55.7	55.5	55.2
Personal Income Taxes	22.3	22.5	22.1	22.2	21.9	22.0	22.1	22.1	22.1	22.1
Labor Market Contributions	4.4	4.5	4.5	4.5	4.5	4.5	4.6	4.6	4.6	4.6
Pension Return Taxes	0.8	0.1	0.1	0.4	0.7	0.7	0.8	0.8	0.8	0.8
Company Taxes	2.4	3.1	2.9	2.9	2.8	2.7	2.6	2.5	2.5	2.4
VAT	9.7	9.7	9.7	9.7	9.8	9.9	9.8	9.8	9.7	9.7
Social Contributions	2.3	2.2	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Interest and Dividends	2.5	2.6	2.3	2.5	2.2	2.2	2.2	2.2	2.2	2.2
Other revenues	12.1	12.4	12.8	12.2	12.4	12.3	12.2	12.1	12.0	11.9
Surplus	2.5	2.8	1.6	1.2	1.2	1.4	1.7	1.9	1.9	1.9
Gross Debt	47.4	45.4	45.7	43.3	41.7	39.6	37.3	35.0	32.7	30.5

Sources: Danmarks Ministry of Finance, Staff Estimates.

Denmark: Basic Data

Total area 43,094 square kilometers  
Total population (2000) 5.3 million

	2002 In billions of krone	2002 In percent of GDP	1997	1998	1999	2000	2001	2002	2003	2004 proj.
	( At current prices)		(Percentage change at 1995 prices)							
Demand and supply 1/										
Private consumption	642	47.2	2.9	2.3	0.7	-0.7	-0.2	0.6	1.1	3.0
Public consumption	359	26.3	0.8	3.1	2.0	0.9	2.7	2.1	0.5	0.7
Gross fixed investment	283	20.8	10.9	10.1	1.5	6.9	4.9	4.5	-0.4	2.5
Residential buildings	61	4.5	7.1	4.2	-1.0	7.7	-5.3	10.5	7.8	3.0
Inventory accumulation 2/	1	0.1	0.9	-0.1	-1.1	1.0	-0.7	0.0	-0.4	0.0
Total domestic demand	1,284	94.3	4.9	4.0	0.1	2.4	1.0	1.9	0.1	2.3
Exports of goods and nonfactor services	603	44.3	4.1	4.3	12.3	13.5	4.4	4.8	0.3	3.1
Imports of goods and nonfactor services	526	38.6	10.0	8.9	5.5	13.5	3.5	7.3	-0.4	4.3
Foreign balance 2/	77	5.7	-1.7	-1.4	2.6	0.5	0.6	-0.8	0.3	-0.4
GDP	1,361	100	3.0	2.5	2.6	2.8	1.6	1.0	0.4	1.8
Output gap (in percent of potential GDP)			0.1	-0.1	0.2	0.9	0.7	0.1	-1.1	-1.1
			(In percent of GDP)							
Saving 1/										
Private			18.9	18.0	17.1	19.0	21.5	20.8	21.0	20.8
Public			2.3	2.8	4.8	5.0	2.9	2.0	1.5	1.2
			(Percentage change)							
Employment and unemployment 1/										
Labor force			0.5	0.3	0.4	0.4	0.4	-0.3	-0.4	0.5
Employment			1.6	1.7	1.3	0.7	0.6	-0.4	-1.3	0.3
Unemployed 3/			7.7	6.4	5.5	5.1	4.9	4.9	5.8	6.0
			(Percentage change)							
Prices and incomes										
GDP deflator			2.2	1.0	1.8	3.0	2.1	1.6	2.1	1.6
Consumer price index			2.2	1.8	2.5	2.9	2.4	2.3	2.1	1.7
Hourly wages										
(Private sector)			3.8	4.4	4.1	3.6	4.3	4.0	4.2	3.0
Unit labor costs (manufacturing)			-3.9	1.9	0.3	-1.7	2.1	1.0	3.2	1.3

## Denmark: Basic Data (concluded)

	2002 In billions of krone	1997	1998	1999	2000	2001	2002	2003	2004 proj.
(In percent of GDP, unless otherwise noted)									
Public finances 1/ General government									
Expenditure	742	57.2	56.7	55.4	53.9	54.2	54.6	54.8	54.7
Revenue 4/	764	57.6	57.9	58.6	56.5	57.1	56.1	56.0	55.9
Financial balance 4/	21	0.4	1.1	3.2	2.5	2.8	1.6	1.2	1.2
General government debt	622	61.2	56.2	53.0	47.4	45.4	45.7	43.3	41.7
(In billions of DKr., unless otherwise noted)									
Balance of payments									
Merchandise trade balance (f.o.b.)		38.4	25.3	46.7	54.1	61.7	60.1	66.8	57.1
Non-factor services balance		0.8	-2.0	11.1	22.1	25.0	18.1	24.8	19.5
Net factor income		-22.5	-18.4	-17.4	-32.8	-25.0	-27.5	-26.1	-24.1
Net transfers		-12.3	-15.2	-19.3	-24.8	-21.3	-23.0	-25.1	-26.0
Current account		4.4	-10.2	21.2	18.6	40.5	27.6	41.7	26.5
(In percent of GDP)		0.4	-0.9	1.8	1.5	3.1	2.0	3.0	1.8
Financial account		56.0	10.8	-28.9	-18.5	-40.2	-28.3	-41.4	...
Foreign direct investment		-10.4	16.9	-6.8	59.4	-25.2	13.7	9.5	...
Portfolio investment		33.0	-64.9	-22.6	-147.1	-35.3	1.0	-117.7	...
Other		33.5	29.6	62.5	23.4	42.0	-1.0	98.3	...
Derivatives		0.0	0.0	2.3	2.9	5.8	3.4	-0.7	...
Net increase (+) of foreign exchange reserves less gold (percent)		35.2	-20.2	46.0	-32.2	13.3	57.7	37.5	20.5
Foreign exchange reserves (US\$, e. o. p.)		18.2	13.8	21.1	14.5	16.1	25.9	36.0	34.1
(Percentage changes, end of period )									
Monetary data									
Broad money (national definition)		5.2	2.9	4.1	2.0	8.0	10.7	12.5	...
Domestic credit 5/		7.6	9.4	5.8	11.4	9.5	5.1	6.3	...
(Period averages in percent)									
Interest rates 6/									
Three-month euro rate		3.7	4.2	3.3	4.9	4.6	3.5	2.4	2.1
differential with Germany		0.4	0.7	0.4	0.6	0.4	0.2	0.1	0.1
Yield on ten-year government bonds		6.3	4.9	4.9	5.7	5.1	5.1	4.3	5.0
differential with Germany		0.6	0.4	0.4	0.4	0.3	0.3	0.2	0.2
(Levels)									
Exchange rates									
DKr per US\$ (end of period)		6.8	6.4	7.4	8.0	8.4	7.1	6.0	...
DKr per US\$ (annual average)		6.6	6.7	7.0	8.1	8.3	7.9	6.6	...
Euro per US\$		...	...	...	1.08	1.12	1.14	1.13	...
Nominal effective rate (1995=100)		95.9	96.5	95.4	91.9	93.3	93.8	96.7	...
Real effective rate (1995=100) 7/		95.8	97.4	97.2	94.2	95.6	97.0	101.3	...

Sources: IMF, International Financial Statistics; IMF, World Economic Outlook; and staff projections.

1/ Staff estimates.

2/ Change as percent of previous year's GDP.

3/ In percent of labor force.

4/ Fiscal revenues and financial balance from 2002 reduced by 0.5 percent of GDP due to a transfer of pensions to private sector.

5/ Banks and mortgage-credit institutions.

6/ Data for 2004 refer to April 20, 2004.

7/ Based on relative normalized unit labor cost in manufacturing.

**Denmark: Fund Relations**

(As of April 30, 2004)

I. **Membership Status:** Joined March 30, 1946. Denmark has accepted the obligations of Article VIII.

II. <b>General Resources Account:</b>	SDR Million	Percent Quota
Quota	1,642.80	100.00
Fund holdings of currency	1,008.08	61.36
Reserve Tranche position	634.73	38.64

III. <b>SDR Department:</b>	SDR Million	Percent Allocation
Net cumulative allocation	178.86	100.00
Holdings	38.99	21.80

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to Fund:** None.

VII. **Exchange Rate Arrangements:**

- Denmark participates in the exchange rate mechanism II (ERMII). It maintains 2¼ percent fluctuation margins vis-à-vis the euro with a central fixed rate at DKr 746.038 per €100.
- In accordance with UN resolutions and EU restrictive measures, Denmark applies targeted financial sanctions under legislation relating to Al-Qaeda or Taliban, and individuals, groups, and organizations associated with terrorism; certain persons associated with the former Government of Iraq and its state bodies; specific assets of certain persons associated with to important government functions in Myanmar; funds related to military activities in Somalia; funds in relation to Mr. Milosevic and those persons associated with him; funds, other financial assets and economic resources of individual members of the Zimbabwe Government and natural or legal persons associated with them; certain claims by Libya, Liberia, Sudan, Republic of Congo, and the Haitian authorities. These restrictions have been notified to the Fund under Decision 144-(52/51).

VIII. **Article IV Consultation:** Denmark is on the 24-month consultation cycle. The staff report for the last Article IV consultation (IMF Country Report No. 02/101) was discussed at EBM/02/47 (May 8, 2002).

IX. **Technical Assistance:** None.

X. **Resident Representative:** None.



### **Denmark: Statistical Appendix**

Denmark has a full range of statistical publications, many of which are on the Internet. The quality and timeliness of the economic database are very good and generally adequate for surveillance purposes. Denmark subscribes to the Fund's Special Data Dissemination Standard (SDDS). Metadata are posted on the Dissemination Standards Bulletin Board.

The gap between exports based on trade data (collected by Danmarks Statistik) and exports based on balance of payments statistics (collected by the Nationalbank Danmark) has widened in recent years. The discrepancy reflects different sources of information and methodologies used by the two organizations. Ongoing discussions between the two organizations, however, have not yet led to a satisfying reconciliation of the two data series.

The authorities have introduced new data on monetary financial institutions that conform to the *ESA95* and expand the set of financial institutions covered in the Nationalbank's statistical bulletin. This permits an examination of some categories of financial institutions not covered before (e.g. money market funds, small banks, and cooperative banks) allowing a more thorough look at the financial sector. Some of the financial account data come from this enhanced source. Data for the central bank and other depository corporations are reported to STA on a timely and regular basis.

Denmark subscribes to the Fund's Special Data Dissemination Standards (SDDS). Metadata are posted on the Dissemination Standards Bulletin Board.

Denmark: Core Statistical Indicators  
as of June 1, 2004

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	4/04	4/04	4/04	4/04	4/04	4/04	4/04	3/04	12/03	12/02	2003 Q4	2002
Date Received	5/04	5/04	5/04	5/04	5/04	5/04	5/04	5/04	3/04	02/04	4/04	02/04
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annual	Quarterly	Annual
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annually	Quarterly	Annually
Source of Update	TRE database; RES database	Press Release	Press Release	IFS submittance	Bloomberg	TRE database; RES database	Electronic update	Electronic update	Electronic update	Electronic update	Electronic update	Electronic update
Mode of Reporting	Electronic	Publication	Publication	Publication	Publication	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic
Confidentiality	None	None	None	None	None	None	None	None	None	None	None	None
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annually	Quarterly	Annually

### **Denmark: Sustainability Analysis**

1. Fiscal and external debt sustainability assessments were conducted over the medium term applying standardized sensitivity tests to the staff's baseline projections.

#### **A. Fiscal Sustainability**

2. The staff's baseline scenario predicts a decline in the public debt to GDP ratio from 43.3 in 2003 to 32.7 in 2008, and the different sensitivity tests suggest medium-term debt sustainability is not at risk (Table A1) if the authorities pursue a course of fiscal consolidation. Thus, the alternative scenarios or the bound tests suggest little risk of sustainability problems. The worst outcome in the bound tests (test B2) only predict that the debt ratio at the end of the period will increase by around 5 percentage points from current levels. In all other tests the debt ratio falls over the projection horizon.

#### **B. External Sustainability**

3. External debt sustainability does not appear to be an issue in Denmark. Denmark has registered current account surpluses through most of the 1990s and its net investment position improved markedly from about negative 30 percent of GDP in early 1990s to negative 15 percent of GDP in 2003 (Table A2). Gross external debt increased from 115 to 130 percent of GDP during 1999–2003 but this was accompanied by a substantial increase in gross external assets; the net external debt declined from 34 percent of GDP to about 28 percent (Table A3). With sustained current account surplus projected over the medium-term, Denmark's net investment position is projected to strengthen further. Table A3 provides a summary set of external and financial vulnerability indicators as well.

Table A1. Denmark: Public Sector Debt Sustainability Framework, 1998-2008  
(In percent of GDP, unless otherwise indicated)

	Actual										Projections							Debt-stabilizing prim. bal. 10/					
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008							
	<b>I. Baseline Projections</b>																						
<b>Public sector debt 1/</b>	78.0	73.5	69.3	65.1	61.2	56.2	53.0	47.4	45.4	45.7	<b>43.3</b>	<b>41.7</b>	<b>39.6</b>	<b>37.3</b>	<b>35.0</b>	<b>32.7</b>	<b>1.1</b>						
o/w foreign-currency denominated	13.4	12.6	11.9	11.1	9.9	7.6	7.5	6.7	6.3	6.2	6.0	6.0	6.0	6.0	6.0	6.0							
Change in public sector debt	11.9	-4.6	-4.2	-4.2	-3.9	-4.9	-3.3	-5.6	-2.0	0.3	-2.3	-1.6	-2.1	-2.3	-2.4	-2.3							
Identified debt-creating flows (4+7+12)	2.0	-2.8	-1.1	-2.5	-3.6	-3.2	-5.7	-5.5	-4.5	-2.7	-2.3	-2.6	-3.1	-3.3	-3.4	-3.3							
Primary deficit	-4.3	-4.2	-4.1	-5.1	-6.1	-6.5	-8.0	-6.9	-6.9	-5.2	-4.6	-4.4	-4.5	-4.6	-4.6	-4.4							
Revenue and grants	58.1	58.5	57.3	58.1	57.6	57.9	58.6	56.5	57.1	56.1	56.0	55.9	55.8	55.9	55.7	55.5							
Primary (noninterest) expenditure	53.8	54.3	53.2	52.9	51.5	51.4	50.7	49.6	50.2	50.9	51.4	51.6	51.4	51.3	51.1	51.0							
Automatic debt dynamics 2/	6.4	1.4	3.0	2.6	2.4	3.3	2.3	1.4	2.3	2.5	2.3	1.7	1.4	1.3	1.2	1.2							
Contribution from interest rate/growth differential 3/	6.3	1.3	3.2	2.8	2.5	3.3	2.3	1.4	2.4	2.5	2.3	1.7	1.4	1.3	1.2	1.2							
Of which contribution from real interest rate	6.3	5.3	5.1	4.5	4.3	4.7	3.7	2.8	3.1	3.0	2.5	2.5	2.4	2.2	2.0	1.8							
Of which contribution from real GDP growth	0.0	-4.0	-1.9	-1.7	-1.8	-1.5	-1.4	-1.4	-0.7	-0.4	-0.2	-0.8	-1.0	-0.9	-0.8	-0.6							
Contribution from exchange rate depreciation 4/	0.1	0.1	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...							
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0							
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0							
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0							
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0							
Residual, including asset changes (2-3) 5/	9.8	-1.8	-3.1	-1.7	-0.3	-1.7	2.4	-0.1	2.5	3.1	0.0	1.0	1.0	1.0	1.0	1.0							
Public sector debt-to-revenue ratio 1/	134.2	125.6	121.0	112.1	106.3	97.2	90.3	84.0	79.5	81.4	77.4	74.5	71.0	66.8	62.8	59.0							
<b>Gross financing need 6/</b>	30.5	31.7	30.4	27.4	23.0	22.7	17.1	16.3	15.0	16.8	17.6	16.6	15.5	14.3	13.3	12.3							
in billions of Euro	35.8	40.0	40.2	38.6	34.4	35.3	27.9	27.9	26.7	30.7	33.0	32.2	31.4	30.2	29.1	28.0							
<b>Key Macroeconomic and Fiscal Assumptions</b>																	<b>Projected Ave.</b>						
Real GDP growth (in percent)	0.0	5.5	2.8	2.5	3.0	2.5	2.6	2.8	1.6	1.0	0.4	1.8	2.5	2.3	2.1	1.9	1.8						
Average nominal interest rate on public debt (in percent) 7/	11.0	9.1	9.1	9.3	9.3	9.0	8.8	8.6	8.8	8.3	7.7	7.6	7.6	7.6	7.6	7.6	7.6						
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	9.6	7.4	7.4	6.8	7.1	8.0	7.0	5.6	6.7	6.7	5.6	6.0	6.0	5.9	5.5	5.4	5.7						
Nominal appreciation (increase in Euro dollar value of local currency, in percent)	-0.7	-0.6	1.4	1.2	0.4	0.0	0.1	-0.3	0.4	0.2	...	...	...	...	...	...	...						
Inflation rate (GDP deflator, in percent)	1.4	1.7	1.8	2.5	2.2	1.0	1.8	3.0	2.1	1.6	2.1	1.6	1.6	1.7	2.1	2.2	1.9						
Growth of real primary spending (deflated by GDP deflator, in percent)	3.9	6.4	0.6	2.1	0.1	2.4	1.1	0.7	2.8	2.4	1.4	2.1	2.1	2.1	1.8	1.7	1.9						
Primary deficit	-4.3	-4.2	-4.1	-5.1	-6.1	-6.5	-8.0	-6.9	-6.9	-5.2	-4.6	-4.4	-4.5	-4.6	-4.6	-4.4	-4.5						
																	<b>Debt-stabilizing prim. bal. 10/</b>						
<b>A. Alternative Scenarios</b>																							
A1. Key variables are at their historical averages in 2004-08 8/																	<b>43.3</b>	<b>40.6</b>	<b>37.7</b>	<b>34.7</b>	<b>31.6</b>	<b>28.3</b>	<b>1.3</b>
<b>B. Bound Tests</b>																							
B1. Real interest rate is at historical average plus two standard deviations in 2004 and 2005																	<b>43.3</b>	<b>43.1</b>	<b>42.4</b>	<b>40.2</b>	<b>37.9</b>	<b>35.8</b>	<b>1.2</b>
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005																	<b>43.3</b>	<b>43.9</b>	<b>46.0</b>	<b>46.7</b>	<b>47.4</b>	<b>48.3</b>	<b>1.6</b>
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005																	<b>43.3</b>	<b>43.0</b>	<b>42.4</b>	<b>40.2</b>	<b>37.9</b>	<b>35.7</b>	<b>1.2</b>
B4. Combination of 2-4 using one standard deviation shocks																	<b>43.3</b>	<b>43.0</b>	<b>42.7</b>	<b>40.5</b>	<b>38.3</b>	<b>36.2</b>	<b>1.2</b>
B5. One time 30 percent real depreciation in 2004 9/																	<b>43.3</b>	<b>44.6</b>	<b>42.6</b>	<b>40.4</b>	<b>38.2</b>	<b>36.0</b>	<b>1.2</b>
B6. 10 percent of GDP increase in other debt-creating flows in 2004																	<b>43.3</b>	<b>51.7</b>	<b>50.0</b>	<b>48.0</b>	<b>46.0</b>	<b>44.1</b>	<b>1.5</b>

1/ General government gross debt

2/ Derived as  $[(r - \pi(1+g) - g + \alpha\epsilon(1+r))/(1+g+\pi+g\pi)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\epsilon$  = nominal exchange rate depreciation (measured by increase in local currency value of Euro).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\epsilon(1+r)$ .

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ Derived as nominal interest expenditure divided by previous period debt stock.

8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in Euro value of local currency) minus domestic inflation (based on GDP deflator).

10/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table A2. Denmark: Net Investment Position 1/  
(Percent of GDP)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Assets</b>	<b>87</b>	<b>72</b>	<b>71</b>	<b>84</b>	<b>98</b>	<b>111</b>	<b>145</b>	<b>161</b>	<b>161</b>	<b>159</b>	<b>170</b>
Direct investment abroad	15	16	17	18	20	22	31	46	50	44	44
Portfolio investment abroad	13	11	13	17	23	29	45	53	54	45	54
Equity securities	6	6	6	9	14	19	32	35	30	19	22
Debt securities	7	5	7	8	9	10	13	18	24	26	33
Other investment abroad	51	40	35	41	44	52	50	52	45	56	55
Trade credits	5	4	3	4	4	4	4	4	4	4	4
Loans, currency and deposits	42	32	29	34	37	38	38	37	31	33	38
Other	4	4	2	3	3	10	8	11	9	18	13
Reserve assets	8	6	7	8	12	9	19	9	11	14	16
<b>Liabilities</b>	<b>120</b>	<b>99</b>	<b>98</b>	<b>108</b>	<b>123</b>	<b>136</b>	<b>157</b>	<b>178</b>	<b>178</b>	<b>177</b>	<b>185</b>
Direct investment in Denmark	14	15	17	15	16	20	29	46	48	43	44
Portfolio investment in Denmark	63	46	49	57	65	63	64	68	72	67	70
Equity securities	2	4	5	7	12	12	13	17	15	11	14
Debt securities	61	42	44	50	53	51	51	51	57	56	56
Other investment in Denmark	42	38	32	36	42	53	59	64	58	67	71
Trade credits	2	2	2	3	3	2	2	2	2	2	2
Loans, currency and deposits	37	33	28	31	37	43	51	53	48	49	59
Other	3	3	2	2	2	8	6	9	8	16	10
Reserve assets	0	0	0	0	0	0	5	0	0	0	0
<b>Net investment position</b>	<b>-32</b>	<b>-27</b>	<b>-27</b>	<b>-24</b>	<b>-25</b>	<b>-24</b>	<b>-13</b>	<b>-17</b>	<b>-17</b>	<b>-18</b>	<b>-15</b>
Direct investment	1	1	0	3	4	2	2	0	2	1	0
Portfolio investment	-50	-35	-36	-40	-43	-34	-19	-14	-18	-22	-15
Equity securities	4	1	1	2	1	7	19	18	15	8	8
Debt securities	-53	-36	-38	-42	-44	-41	-38	-33	-33	-30	-23
Other investment	8	1	3	5	2	-1	-9	-12	-13	-11	-16
Trade credits	2	2	1	1	1	2	2	2	2	2	2
Loans, currency and deposits	5	-2	1	3	-1	-5	-14	-16	-16	-16	-21
Other	1	1	1	1	1	2	2	2	1	3	3
Reserve assets	8	6	6	8	12	9	14	9	11	14	16
Net investment position, excluding direct investment	-33	-28	-27	-27	-29	-26	-15	-17	-19	-19	-15

Source: Danmarks Nationalbank

1/ Data correspond to the end of the indicated period.

Table A3: Denmark: Indicators of External and Financial Vulnerability  
(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	2003
<b>External Indicators</b>					
Exports (annual percentage change, in U.S. dollars)	2.5	2.2	1.6	1.6	1.9
Imports (annual percentage change, in U.S. dollars)	2.3	2.2	1.5	1.6	1.9
Terms of trade (annual percentage change)	1.4	1.1	0.2	0.4	2.1
Current account balance	1.8	1.5	3.1	2.0	2.9
Capital and financial account balance (incl. errors but excl. reserves)	-1.6	3.6	-4.8	-1.0	1.3
Official Reserves (in billions of U.S. dollars, end-of-period)	22.6	14.6	17.6	27.2	37.7
Broad money to reserves ratio	3.0	4.3	3.5	2.8	2.5
Central bank foreign liabilities (in billions of U.S. dollars)	7.8	0.4	0.5	0.6	0.5
Foreign assets of the banking sector (in billions of U.S. dollars)	77.8	78.8	66.2	92.4	116.6
Foreign liabilities of the banking sector (in billions of U.S. dollars)	69.1	83.0	82.0	118.1	161.2
Official reserves in months of imports of goods and nonfactor services	4.7	2.7	3.3	4.1	4.9
Total gross external debt	114.8	114.6	115.0	120.7	131.3
Of which: General government debt	28.3	24.8	22.5	21.2	18.1
Net external debt	33.6	35.2	34.4	24.3	28.3
Gross external debt to exports ratio	284.6	245.2	242.3	254.3	286.4
External interest payments to exports (in percent)	12.7	12.2	12.4	10.8	9.4
Exchange rate against U.S. dollar (period average)	7.0	8.1	8.3	7.9	6.6
<b>Financial Markets Indicators</b>					
Public sector debt (Maastricht definition)	53.0	47.4	45.4	45.7	43.8
3-month CIBOR yield	3.7	5.4	3.6	3.0	2.2
3-month CIBOR yield (real)	1.7	2.6	1.4	1.0	0.2
Change in KFX stock market index (percent, end of period)	16.6	22.8	-13.8	-26.3	22.5
Spread of 3-month CIBOR with the FIBOR/EURIBOR (basis points, e.o.p.)	38.9	52.3	32.9	14.8	8.8
Spread of 10-year gov't bond with the 10-yr Bund (basis points, e.o.p.)	29.2	28.8	20.7	11.5	20.0
<b>Financial Sector Indicators</b>					
MFIs (banks and mortgage credit institutes)					
Share of external assets in total assets (percent)	29.7	27.9	24.9	27.3	28.0
Loans to residents in foreign currency (in billions of U.S. dollars)	...	14.0	22.1	29.4	35.0
Share in total lending (percent)	...	6.4	9.6	10.3	9.7
Residents' deposits in foreign currency (in billions of U.S. dollars)	...	3.8	3.4	3.7	4.1
External position (in billions of U.S. dollars)	22.1	5.8	-6.8	-9.0	-11.9
Banks					
Share of non-resident deposits in total deposits (percent)	10.8	10.6	10.5	11.7	10.6
Net foreign inter-bank lending (in billions of U.S. dollars)	-17.6	-18.3	-19.7	-22.6	...
Return on equity after taxes (percent)	13.0	14.3	13.0	12.1	15.5
Operating income over operating expenses	1.5	1.6	1.6	1.6	1.7
Solvency ratio (percent)	11.0	9.9	10.4	10.6	10.9
Core capital ratio (percent)	7.7	7.0	7.4	7.7	7.8
Mortgage credit institutes					
Share of mortgage credit institute lending in total MFI lending (percent) 1/	53.3	51.7	52.1	52.7	52.9
Share of owner-occupied homes in mort. credit inst. lending (percent)	56.7	57.4	58.5	58.9	59.3
Loans to value ratio	0.62	0.62	0.64	0.67	...
Share of adjustable rate mortgages in total mortgage lending (percent)	5.7	9.1	20.6	28.4	35.8
Return on equity after taxes (percent)	6.1	6.7	6.0	5.3	7.8
Operating income over operating expenses	2.6	3.0	2.7	2.6	3.2
Solvency ratio (percent)	12.6	12.6	11.5	11.7	11.6
Core capital ratio (percent)	11.2	11.5	11.1	11.2	11.0

Sources: Danmarks Nationalbank; IMF, International Financial Statistics; IMF, World Economic Outlook.

**Statement by the IMF Staff Representative  
August 2, 2004**

This note updates key developments in Denmark since the drafting of the staff report for the Article IV consultation. The thrust of the staff appraisal remains unchanged.

1. **Denmark's GDP growth in the first quarter of 2004 was somewhat faster than expected.** The expansion of consumption spending continued in the first quarter and external demand was also above expectation; 12-month growth registered 1.4 percent. Leading indicators in Denmark have strengthened recently, particularly consumer confidence. With activity in the euro area in the first quarter also picking up, staff considers that GDP growth in Denmark for 2004 is likely to be just above 2 percent, up from the 1.8 percent contained in the staff report.
2. **Recent fiscal data continue to show a strong underlying position, but suggest that alignment with public consumption targets remains a challenge.** The general government fiscal outcome for 2003 was in line with staff estimates with a surplus of 1.2 percent of GDP, although both expenditures (for public consumption) and revenues were higher than expected. Data for the first quarter of 2004 showed an improvement in the surplus compared to last year driven by slowing expenditure growth and a pick-up in revenue collections.
3. **The Welfare Commission released its first report on the sustainability of the Danish welfare system.** It concludes that, under current policies, Danes will draw more in benefits from the welfare state over their lifetimes than they contribute to finance them. In comparison with government projections, the Welfare Commission does not make assumptions about further public expenditure compression or labor market reforms, and projects longer life expectancy. Before year end, the commission will offer some specific policy options, with a final report expected in late 2005.
4. **Political agreement has been reached on a model for reorganizing local governments.** The agreement specifies the division of tasks across the three levels of government, the enlargement of the average size of municipalities and the replacement of the current 14 counties with 5 regions. The reform, aimed at improving delivery of public services and harnessing economies of scale, is planned to take effect in January 2007.

**Statement by Benny Andersen, Alternate Executive Director for Denmark  
August 2, 2004**

1. The Danish authorities wish to thank staff for fruitful and thought-provoking policy discussions in Copenhagen and a well-balanced staff report. They will carefully consider the recommendations made by staff.

**Economic prospects**

2. My authorities concur with staff's assessment that conditions appear to be in place for a return to healthy growth. The global economy is recovering, interest rates are low, fiscal policy is supportive, and the financial situation of corporates and households is generally sound. The Danish Finance Ministry sees above-trend GDP growth of 2.2 percent in 2004 and 2.5 percent in 2005, i.e. broadly in line with staff's updated assessment in their Buff/04/144. The unemployment rate is expected to decline from its current 6½ percent to around 5¼ percent in 2005, a level roughly corresponding to the estimated structural level. Downside risks from high oil prices, geopolitical unrest, and high fiscal deficits in most of the major economies seem to be balanced by upside domestic potential from pent-up consumer demand, easy financing terms, and credible tax reductions.

3. The Danish authorities welcome staff's assessment that the recent stimulus package is well-designed and provides a counter-cyclical impetus to growth. The tax reductions have been decided with a view to strengthening labor supply, but the frontloading in 2004 reflects short-term employment considerations. There is some slack in the economy and, based on the above forecast, capacity constraints are not likely to be felt before late 2005 or in 2006. By design, the package has little impact on the fiscal balance or on long-term fiscal sustainability, for reasons explained in the staff report. Also by design, the temporary demand stimulus tapers off in 2006, when capacity constraints more likely could be binding.

4. Inflation is very low, partly for transitory reasons, and the current account as well as public finances show considerable surpluses. As staff note, wage increases have outpaced the average of Denmark's trading partners, but so has productivity. At the current euro-dollar exchange rate, the real effective exchange rate is broadly in line with long-term averages.

**Medium-term policy framework**

5. My authorities welcome staff's support for the medium-term fiscal framework and exchange rate anchor, which form the basis of stability-oriented policies in Denmark.

6. The key fiscal policy objective is that current and planned policies toward 2010 fulfill the objective of long-term fiscal sustainability. This entails that the present welfare provisions can be sustained in the face of future ageing-related spending pressures without raising taxes. The strategy requires fiscal surpluses of 1½-2½ percent of GDP on average toward 2010 and additional structural initiatives in order to increase employment.



7. With tax reductions enacted and the tax freeze technically assumed to remain in force to 2010, key policy requirements consist of the containment of real public consumption growth to ½ percent per year in 2005 to 2010 and reform initiatives to raise structural employment by some 2 percent. The outstanding requirements in terms of fiscal and structural adjustments to ensure sustainability are estimated to be a good deal less in Denmark than in most other OECD countries.

8. The Danish authorities are pleased with staff's view that the Danish fixed exchange rate policy, pursued within the ERM II framework, has served Denmark well as an anchor for expectations, and an effective discipline on fiscal and other economic policies. A fixed exchange rate policy has been a cornerstone in the Danish economic policy for more than two decades. The policy constitutes a strong foundation for price stability in Denmark and the conditions for maintaining it are well understood by wage negotiators and fiscal authorities. The Danish krone rate has remained close to the central parity for many years, and the credibility of the peg is further underscored by low and relatively stable interest rates vis-à-vis the euro area.

### **Fiscal policy issues**

9. In the report, staff cautions that additional fiscal measures may be required to control spending. In this connection, they recommend that expenditure targets be expressed in nominal rather than in real terms and that user fees be considered, including in health care, to better align demand for services with need. In the medium-term fiscal framework, spending paths are projected both in real and nominal terms. What matters for medium and long-term fiscal objectives is how nominal expenditures develop in relation to the nominal tax base, and there are pros and cons of both real and nominal targets. Real spending targets have been emphasized for ex ante planning and prioritization of scarce resources. The monitoring of real targets is hampered by the uncertainties associated with the national accounts deflator for public consumption and hence with the estimated real spending growth. For ex post evaluation, it is crucial to include nominal developments.

10. Spending discipline has improved since the current government took office. For the average of 2002 and 2003, nominal public consumption grew by 4 percent a year. According to preliminary figures, real spending grew by 1½ percent per year on average but clearly decelerated both in nominal and real terms from 2002 to 2003. As a consequence of the previous spending overruns, agreed targets for 2004 imply real consumption growth of less than ½ percent in 2004, as compared with the original target of 0.7 percent growth. User payments are already substantial in large parts of the health sector, including for prescription and non-prescription medicine, private hospitals, dental care, eye care and more. The government is committed to the general principle of equal and free access to public hospital treatment. Moreover, performance-enhancing mechanisms will be strengthened. This includes tying budget allocations to hospitals more closely to their activity performance and facilitating the public's free choice of hospital.

11. With relatively tight spending targets in place, the government is taking steps to get better value for money in the provision of public services. The government favors outsourcing and plans to extend citizens' "free choice" between private and public providers of services, including in the fields of child care, elderly care and more. The division of tasks between local, regional and central governments is being reformed, and larger local and regional units created. Larger units will offer better market opportunities for private firms to compete in the provision of public services and is expected to strengthen the quality of services provided.

### **Structural reforms**

12. The medium-term policy framework requires structural reforms, in addition to those already implemented, that can raise structural employment by almost 2 percent by 2010. As staff note, efforts at increasing labor supply are focused on groups with relatively low participation rates: the young, older workers, and immigrants. Further steps will be taken in these areas. Staff points out that a reduction in the incentives for early retirement would be an important, if politically very sensitive step. The government has established the Welfare Commission in order to promote a wide-ranging public debate of policy challenges and options, and to propose concrete initiatives to increase labor supply. The strategies for employment and productivity are consistent with the Lisbon strategy and with the EU Broad Economic Policy Guideline recommendations to ensure an adequate labor supply in view of ageing. Denmark already fulfills the Lisbon employment objectives.

13. Staff suggests there be further scope to consider changes in tax and labor compensation structures to increase incentives to supply labor or invest in human capital. Efforts to reduce the top marginal tax rate should be pursued, and removing the nominal tax freeze on some components of property taxes could provide the space to do so. Increasing competition in goods markets is seen as a necessary complement to the efforts to increase labor supply.

14. The Danish authorities stress that the tax freeze in its current form is simple, widely understood, and credible. The freeze is a strong commitment device, which is key in arresting and reversing the longstanding upward trend in the tax burden in Denmark.

15. The recent reduction of income taxes has been introduced to stimulate labor supply. The focus on lower marginal tax rates in the middle-income range and the introduction of an earned income tax credit reflect concerns for income distribution and the desire for greater labor participation for individuals with low or moderate earnings potential.

16. The wage distribution is more equal in Denmark than in most other countries, but employment outcomes suggest that this reflects a more equal skill distribution rather than market imperfections. There is no legislated minimum wage in Denmark and under normal conditions the government plays no direct role in wage setting, except in its role as public employer. Relatively high social benefits can set a floor to reservation wages, but unemployment benefits are conditional on strict availability-for-work requirements and, after

6 or 12 months of unemployment, mandatory participation in active labor market programs. Unemployment is not particularly concentrated among low-skilled workers, compared to other countries. Moreover, the relative employment opportunities for low-skilled workers have not deteriorated over recent decades, in contrast to several other EU countries. This reflects increasing average educational attainment and labor market reforms that have made it impossible to receive passive benefits for extended periods. The government is conscious of the need to further strengthen education and training achievements, in particular in engineering and science majors. Funds are being set aside to strengthen science teaching already in primary schools.

17. Product market reforms are an essential complement to labor market reforms, as highlighted also by staff's competent selected issues paper. Efforts will be continued in the areas noted in the staff report and within the framework of the government's growth strategy.

### **Financial sector issues**

18. Danish banks have continued to present sound earnings with substantial profits. The overall assessment is that resilience remains unchanged for the Nordic banking groups, while large capital gains and robust income performance have strengthened the resilience of the Danish banking institutions significantly compared to 2002. The pressure on the pension companies has subsided as a result of the development in asset prices. Furthermore, the risks related to liabilities linked to interest guarantees have to a high degree been hedged through various financial instruments. The households' debt as a ratio to disposable income is still increasing, but the ability to meet payments has improved owing to the low level of interest rates. Households in Denmark have a higher level of debt in relation to disposable income than in the other Nordic countries, but on the other hand housing wealth as a ratio of income is higher in Denmark. While the share of adjustable rate mortgages have increased significantly, almost 60 percent of mortgage loans are still fixed-rate, and the introduction of loans free of repayment for up to 10 years (which may be rolled over) provide households with increased financial flexibility in the face of temporary income shocks, e.g. unemployment spells. The Danish authorities look forward to the FSAP planned to take place in the context of the next Article IV consultation cycle.

### **Other issues**

19. In the context of EU membership, Denmark supports further trade liberalization in the Doha round and market-oriented reform of the EU's common agricultural policy.

20. Since 1978, Denmark has consistently provided development assistance of more than 0.7 percent of gross national income, among the highest of any country as noted by staff.



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## **IMF Concludes 2004 Article IV Consultation with Denmark**

On August 2, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Denmark.<sup>1</sup>

### **Background**

Denmark enjoyed a period of rapid economic growth over most of the 1990s. The fixed exchange rate regime provided an anchor for inflation expectations and underpinned an economic policy directed toward ensuring sound macroeconomic fundamentals. Labor market reforms led to a sustained increase in structural employment, while careful fiscal policy in the context of a clear medium-term sustainability strategy delivered budget surpluses and a steady decline in government debt as a share of GDP. In addition, overall national savings contributed to persistent current account surpluses and a decline in net foreign liabilities.

In 2001, growth started to slow, reflecting domestic initiatives to cool overheating and the downturn in the global economy. By end 2003, output was about one percent below potential, and unemployment had risen somewhat to 6½ percent. In early 2004, conditions appear to be in place for a return to healthy growth: supportive monetary and fiscal policy; healthy domestic balance sheets; strengthening and broadening in the global recovery; and leading indicators suggesting that the pickup in the domestic economy witnessed in late 2003 continues to gain

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities and this PIN summarizes the views of the Executive Board.

momentum. IMF staff forecast growth to be close to 2 percent in 2004, increasing to 2½ percent in 2005.

Denmark's fixed exchange rate regime continues to serve the country well. Inflation has been low and stable and spreads against euro area interest rates are negligible. Currently, inflation in Denmark is below that in the euro area and is projected to remain subdued. Although the impact of the reduction in indirect taxes and euro appreciation are temporary, capacity constraints are unlikely to be reached until the end of 2005.

Fiscal policy in Denmark is based on a medium-term strategy to accommodate the pressures from an aging population while maintaining the welfare state without increasing taxes. The strategy calls for fiscal surpluses between 1½ and 2½ percent of GDP, annual growth in public consumption being constrained to 0.5 percent, and a 2 percent increase in structural employment by 2010. Denmark is relatively better prepared to deal with the costs of aging than many other countries--members of the Organization for Economic Cooperation and Development (OECD)--but the authorities recognize that additional resolve will be needed to assure the realization of the employment and expenditure targets

Labor market policy is currently focused on increasing the participation rates of both the young and the elderly, and first- and second-generation immigrants. Additionally, the authorities continue to peruse structural reforms aimed at increasing competitiveness in goods markets. To constrain public consumption expenditure, a tax freeze has been implemented with legally binding rules for compliance and the authorities stand ready to implement additional measures if expenditure slippages emerge.

### **Executive Board Assessment**

Executive Directors commended the Danish authorities for their record of sustained structural reform and strong fiscal policy, grounded in a medium-term framework, that has led to fiscal surpluses and a significant reduction in public debt. As a result, the Danish economy has weathered the recent global slowdown and is now well placed to benefit from the global recovery. Several Directors underscored that the Danish experience in many areas offers useful lessons for other countries and represents a good example that it is possible to combine a strong welfare state with high employment and growth. While acknowledging that Denmark has already made considerable progress in preparing for the medium-term challenges of population aging, Directors encouraged further efforts at containing public expenditure and increasing employment toward this goal.

Directors welcomed the indications that economic activity is rebounding. With external conditions improving, and appropriately supportive monetary and fiscal policies in place, Directors saw good prospects for economic recovery in 2004 and for it to gather strength in 2005. The main risks to this outlook stem from the possibility that the recovery in key trading partners might turn out slower than expected, or that growth in private consumption may flag if the pickup in employment is delayed. Some Directors also pointed to the potential impact on

demand of future interest rate increases. Risks to the outlook from a sharp correction in housing prices, which have risen gradually over a long period, appear to be well contained.

Directors generally agreed that Denmark's recent fiscal stimulus package was well designed to provide support for the upturn, without undermining medium-term fiscal objectives, while also addressing some longer term structural issues. They cautioned, however, that further fiscal stimulus should be kept as an exceptional response, to avoid jeopardizing the credibility of the medium-term targets.

Directors agreed that Denmark's fixed exchange rate has been a central pillar of the macroeconomic stability strategy, noting that the low spreads in interest rates vis-à-vis the euro area attest to the credibility of the peg. It has served the country well by both anchoring expectations, and ensuring that fiscal policy is focused on medium-term objectives. Directors judged the overall competitiveness of the Danish economy to be healthy. However, the risks to competitiveness could increase should labor costs outstrip productivity growth, in a context of further euro appreciation, and accordingly Directors considered that efforts to further improve the flexibility of labor markets would be helpful. Even though inflation is likely to remain subdued, Directors stressed that wage moderation will remain key to forestall pressures for the real exchange rate to appreciate.

Directors commended Denmark's sustained implementation of a strong medium-term strategy to deal with the fiscal costs of an aging population. They agreed that efforts to control public expenditure growth and increase employment will remain key pillars of the strategy going forward. While acknowledging the helpful role being played by the 2002 tax freeze and the legally binding rules on counties to comply with budget targets, Directors considered that further action to control public consumption growth may very well be required. Many Directors saw scope for a wider application of user fees to allocate public services more efficiently and contain demand pressures. Some Directors also encouraged the authorities to consider specifying spending targets in nominal terms.

Directors commended the strong performance of the Danish labor market—with employment and labor market participation rates that are high by international standards, notwithstanding the maintenance of a generous welfare system. To alleviate labor supply constraints and lower the structural unemployment rate further, they encouraged the authorities to prepare additional reforms, in particular to reduce incentives for early retirement. In this context, they welcomed the launch of the Welfare Commission to consider the sustainability of the Danish welfare state and outline possible reform options.

Directors welcomed the recent reduction in labor income tax rates. With Denmark's marginal labor income tax rates among the highest in OECD countries, they encouraged the authorities to consider further changes in tax and labor compensation structures that would increase incentives to work. The importance of greater wage dispersion, and better integration of immigrant labor was also highlighted in this context. Directors concurred on the complementary role of product market reforms with labor market reforms. They emphasized that the benefits of labor and product market reform would be greater if accompanied by wider EU reforms.

Directors noted that the Danish financial system has remained resilient despite the three-year slowdown. Directors commended the authorities' sound supervisory framework, and their continued efforts to strengthen it further, particularly in the area of insurance companies and pension funds. They welcomed steps to strengthen cross-border cooperation, in view of increasing cross-border conglomeration and mergers. Directors also welcomed the authorities' planned participation in the Financial Sector Assessment Program, and their efforts to further strengthen the framework for Anti-Money Laundering and Combating the Financing of Terrorism.

Directors commended Denmark's outstanding record in extending official development assistance to developing countries, and looked forward to continued exemplary performance in this area. They also welcomed the authorities' commitment to trade liberalization.

**Public Information Notices (PINs)** Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The Staff Report for the 2004 Article IV Consultation with Denmark is also available.

Denmark: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 proj.
Real economy (change in percent) 1/							
Real GDP	2.5	2.6	2.8	1.6	1.0	0.4	1.8
Net Exports 2/	-1.4	2.6	0.5	0.6	-0.8	0.3	-0.4
Final Domestic demand	4.2	1.2	1.4	1.8	2.0	0.6	2.3
Private consumption	2.3	0.7	-0.7	-0.2	0.6	1.1	3.0
Gross fixed investment	10.1	1.5	6.9	4.9	4.5	-0.4	2.5
Residential buildings	4.2	-1.0	7.7	-5.3	10.5	7.8	3.0
Gross national saving (percent of GDP)	20.8	21.9	24.0	24.4	22.8	22.5	22.0
Gross domestic investment (percent of GDP)	21.7	19.7	21.0	20.5	20.8	19.6	20.1
Labor force	0.3	0.4	0.4	0.4	-0.3	-0.4	0.5
Employment	1.7	1.3	0.7	0.6	-0.4	-1.3	0.3
Unemployment rate (in percent)	6.4	5.5	5.1	4.9	4.9	5.8	6.0
Unit labor cost (manufacturing)	1.9	0.3	-1.7	2.1	1.0	3.2	1.3
GDP deflator	1.0	1.8	3.0	2.1	1.6	2.1	1.6
CPI (year average)	1.8	2.5	2.9	2.4	2.3	2.1	1.7
Public finance (percent of GDP) 1/							
General government revenues 3/	57.9	58.6	56.5	57.1	56.1	56.0	55.9
General government expenditure	56.7	55.4	53.9	54.2	54.6	54.8	54.7
General government balance	1.1	3.2	2.5	2.8	1.6	1.2	1.2
General government structural balance	0.8	2.2	2.1	2.4	1.6	2.1	2.0
General government debt	56.2	53.0	47.4	45.4	45.7	43.3	41.7
Money and credit (end of year, percent change)							
Domestic credit 4/	9.4	5.8	11.4	9.5	5.1	6.3	...
M3	2.9	4.1	2.0	8.0	10.7	12.5	...
Interest rates (percent)							
Money market rate 5/	4.2	3.3	4.9	4.6	3.5	2.4	2.1
Government bond yield 5/	4.9	4.9	5.7	5.1	5.1	4.3	5.0
Balance of payments (In billions of DKr., unless otherwise noted)							
Exports	322.0	347.5	405.3	419.8	436.3	428.9	442.3
Imports	-296.7	-300.8	-351.1	-358.1	-376.2	-362.1	-385.3
Merchandise trade balance (f.o.b.)	25.3	46.7	54.1	61.7	60.1	66.8	57.1
Current account (percent of GDP)	-0.9	1.8	1.5	3.1	2.0	3.0	1.8
Exchange rate							
Exchange rate regime	Participant in ERM2						
Present rate (May 19, 2004)	Danish Kroner 6.206 per US\$1						
Nominal effective exchange rate (1995=100)	96.5	95.4	91.9	93.3	93.8	96.7	...
Real effective exchange rate (1995=100) 6/	97.4	97.2	94.2	95.6	97.0	101.3	...

Sources: IMF, International Financial Statistics; IMF, World Economic Outlook; and IMF staff projections.

1/ Staff estimates.

2/ Contribution to GDP growth.

3/ Fiscal revenues and financial balance from 2002 reduced by 0.5 percent of GDP due to a transfer of pensions to private sector.

4/ Lending growth for banks and mortgage institutions.

5/ Data for 2004 refer to April 2004.

6/ Based on relative normalized unit labor cost in manufacturing.